State aid to state owned enterprises in South Africa: The need for a comprehensive State aid policy
A competition law inquiry

by

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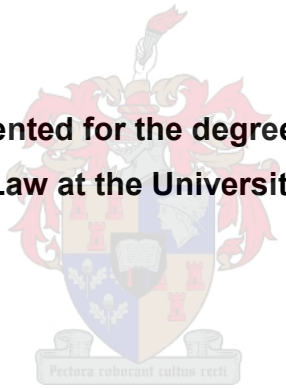

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SUMMARY

The Competition Act 89 of 1998 applies equally to all firms with regard to anti-competitive behaviour regardless whether it is privately or publicly owned. Therefore it applies to state-owned enterprises (SOEs) if their actions fall short of the Act. There is however one aspect relating to SOEs which is not covered by the application of the Competition Act but may have a significant impact on free and fair competition and can be of big concern for private competitors of SOEs. Since discriminatory policies during Apartheid have created a huge inequality gap in post-Apartheid South Africa, the government has to be actively involved in the economy to address the inequality. Therefore the government uses SOEs as vehicles to achieve its developmental goals. As a result SOEs in South Africa which are active market participants may always rely on the financial support of the state. They may do so purely because of their crucial governmental mandates regardless of financial mismanagement, poor corporate governance and deep seated corruption in almost every SOE. Even though the fundamental need for the existence of SOEs in South Africa is acknowledge, it is argued that state financial aid could qualify as a state-initiated constraint on competition in South Africa as it creates an uneven playing field between SOEs and their private competitors, which is always skewed in favour of the SOEs. It may create warped incentives and SOEs may not compete efficiently if they know that they are protected by a state sponsored safety net. This dissertation asks the question whether the time has not arrived in South Africa for state aid to SOEs to be subjected to a certain degree of scrutiny in order to bring about a level playing field between SOEs and their private competitors. It is recognised that privatisation of SOEs is not always the better option as it could threaten the delivery of basic services and goods to poorer South Africans. Hence, the dissertation investigates whether a state aid control model, based on the European Union state aid rules, is not perhaps a solution to address the potential distortion of free and fair competition by state financial aid. It proposes a customised state aid control regime for South Africa which provides for an active role by the competition authorities in state aid decisions and it presents draft legislation which could be used as a basis for the implementation in South Africa of a regulated system of state financial aid to SOEs (and even private enterprises where applicable).

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OPSOMMING

Die Wet op Mededinging 89 van 1998 is gelykerwys op alle ondernemings van toepassing, ongeag of die onderneming in privaat- of staatsbesit is. Gevolglik is dit ook van toepassing of ondernemings wat in staatsbesit is wanneer hulle nie-mededingend optree. Daar is egter een aspek wat verband hou met staatsondernemings wat nie deur die Wet op Mededinging gedek word nie maar wat ‘n groot impak op vrye en regverdige mededinging kan he en wat kan kommer wek by mededingers van staatsondernemings. Aangesien die beleid van Apartheid tot erge ongelykheid, ook in post-Apartheid Suid-Afrika gelei het, is die regering tans aktief betrokke om die ongelykheid reg te stel deur onder andere van ekonomiese maatreëls gebruik te maak. Gevolglik gebruik die regering ondernemings wat in sy besit is om sosio-ekonomiese doelwitte te bereik. As gevolg hiervan kan hierdie ondernemings, selfs al is hulle deelnemers in die markte, altyd staat maak op die finansiële ondersteuning van die staat. Hulle kan dit doen bloot op grond van hulle mandate, selfs al word hulle gekenmerk deur finansiële wanbestuur, swak korporatiewe beheer en erge korrupsie. Hierdie proefskrif gee erkenning aan die bydrae wat ondernemings in staatsbesit maak tot die staat se ontwikkelingsplan. Daar word egter geargumenteer dat die staat se finansiële ondersteuning van hierdie ondernemings kan kwalifiseer as beheer oor mededinging wat deur die staat geïnisieer is, aangesien dit lei tot ’n ongelyke speelveld tussen ondernemings in staatsbesit en private mededingers, wat altyd in die guns van die staatsondersteunde ondernemings is. Dit kan verder lei tot die afwesigheid van motivering in staatsondernemings om effektief met privaat ondernemings mee te ding. Hierdie proefskrif bevraagteken of dit nie nou die tyd in Suid Afrika is om staatsbefondsing van staatsondernemings aan ‘n mate van evaluering onderworpe te stel nie en sodoende ’n gelyke speelveld tussen staats- en private ondernemings mee te bring. Dit erken dat privatisering nie altyd die beter opsie is om die kwessies met staatsbefondsing van staatsondernemings op te los nie, aangesien privatisering die lewering van goedere en dienste aan finansieel kwesbare persone in Suid-Afrika kan affekteer. Gevolglik ondersoek die proefskrif of ’n stelsel vir die beheer van staatsbefondsing van ondernemings wat aan die staat behoort, gebaseer op die Europese Unie se model vir die beheer van staatsbefondsing, moontlik die oplossing vir die kwessies onderliggend aan sodanige befondsing kan wees. Die vraag wat beantwoord moet word is spesifiek of sodanige beheer die bedreiging van vrye en regverdige mededinging deur staatsbefondsing sal verwyder of beperk. Die proefskrif stel ’n stelsel vir die beheer van befondsing aan staatsbeheerde ondernemings voor in terme waarvan Suid Afrika se mededinginsgesag ‘n

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aktiewe rol speel. Dit stel verder ’n konsepwet voor wat kan dien as die basis vir die implementering van ’n stelsel vir die beheer van staatsbefondsing vir staatsbeheerde ondernemings (en ook vir privaat ondernemings indien toepaslik).

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This dissertation is for our beloved son,

NOAH RAINER BACHMANN

YOU ARE THE REASON WHY I PERSEVERED

LOVE YOU FOREVER

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GOD BLESS!!

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LIST OF ABBREVIATIONS

AIG	AMERICAN INTERNATIONAL GROUP
AMC	ANTI-MONOPOLY COMMITTEE OF UKRAINE
ANC	AFRICAN NATIONAL CONGRESS
ARMSCOR	ARMAMENTS CORPORATION OF SOUTH AFRICA SOC LIMITED
AU	AFRICAN UNION
BER	BLOCK EXEMPTION REGULATION
BT	BRITISH TELECOM
CAC	COMPETITION APPEAL COURT
CEE-COUNTRIES	CENTRAL AND EASTERN EUROPEAN COUNTRIES
CEF	CENTRAL ENERGY FUND SOC LTD
CEO	CHIEF EXECUTIVE OFFICER
CJEU	COURT OF JUSTICE OF THE EUROPEAN UNION
COMESA	COMMON MARKET FOR EASTERN AND SOUTHERN AFRICA
COSATU	CONGRESS OF SOUTH AFRICAN TRADE UNIONS
CMA	COMPETITION AND MARKETS AUTHORITY (GREAT BRITAIN)
CSIR	COUNCIL FOR SCIENTIFIC AND INDUSTRIAL RESEARCH
DRCCC	DECLARATION ON REGIONAL COOPERATION IN COMPETITION LAW AND CONSUMER POLICY
DTI	DEPARTMENT OF TRADE AND INDUSTRY
EA	EUROPEAN AGREEMENT
EC	EUROPEAN COMMUNITY
ECOWAS	ECONOMIC COMMUNITY OF WEST AFRICAN STATES
ECSC	EUROPEAN COAL AND STEEL COMMUNITY
EEC	EUROPEAN ECONOMIC COMMUNITY
EMU	EUROPEAN ECONOMIC AND MONETARY UNION
ESCOM/ESKOM	ELECTRICITY SUPPLY COMMISSION
EURATOM	EUROPEAN ATOMIC COMMUNITY
EU	EUROPEAN UNION

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FTC	FEDERAL TRADE COMMISSION
GATT	GENERAL AGREEMENT ON TARIFFS AND TRADE
GBER 2008	GENERAL BLOCK EXEMPTION REGULATION OF 2008
GEAR	GROWTH, EMPLOYMENT AND REDISTRIBUTION POLICY
GWB	ACT AGAINST RESTRAINT OF COMPETITION (GERMANY)
HSRC	HUMAN SCIENCES RESEARCH COUNCIL
IDC	INDUSTRIAL DEVELOPMENT CORPORATION
IMF	INTERNATIONAL MONETARY FUND
IRR	INSTITUTE FOR RACE RELATIONS
ISCOR	IRON AND STEEL CORPORATION
MCC	MOLDOVAN COMPETITION COUNCIL
MEIP	MARKET ECONOMY INVESTOR PRINCIPLE
MRC	MEDICAL RESEARCH COUNCIL
OECD	ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
PAJA	PROMOTION OF ADMINISTRATIVE JUSTICE ACT 3 OF 2000
PARA	PARAGRAPH
PETRO SA	PETROLEUM OIL AND GAS CORPORATION OF SOUTH AFRICA
PFI	PRIVATE FINANCE INITIATIVE
PFMA	PUBLIC FINANCE MANAGEMENT ACT 1 OF 1999
PTA	PREFERENTIAL TRADE AREA FOR EASTERN AND SOUTHERN AFRICAN STATES
PRASA	PASSENGER RAIL AGENCY OF SOUTH AFRICA
RDP	RECONSTRUCTION AND DEVELOPMENT PLAN
SAA	SOUTH AFRICAN AIRWAYS
SAAP	STATE AID ACTION PLAN OF 2005-2009
SABC	SOUTH AFRICAN BROADCASTING CORPORATION
SACCAWU	SOUTH AFRICAN COMMERCIAL, CATERING AND ALLIED WORKERS UNION
SACU	SOUTHERN AFRICAN CUSTOMS UNION
SADC	SOUTHERN AFRICAN DEVELOPMENT COMMUNITY
SADCC	SOUTHERN AFRICAN DEVELOPMENT COORDINATION CONFERENCE

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SADC MoU	MEMORANDUM OF UNDERSTANDING ON INTER-AGENCY COOPERATION IN COMPETITION POLICY, LAW AND ENFORCEMENT
SA EXPRSS	SOUTH AFRICAN EXPRESS (PROPRIETARY) LIMITED
SAFCOL	SOUTH AFRICAN FORESTRY COMPANY
SANRAL	SOUTH AFRICAN NATIONAL ROAD AGENCY SOC LIMITED
SAR	SOUTH AFRICAN RAILWAYS
SME	SMALL AND MEDIUM-SIZED ENTERPRISE
SMME	SMALL, MEDIUM AND MICRO ENTERPRISE
SAPO	SOUTH AFRICAN POST OFFICE
SASOL	SOUTH AFRICAN COAL, OIL AND GAS CORPORATION
SCA	SUPREME COURT OF APPEAL OF SOUTH AFRICA
SCM	AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES
SOE	STATE-OWNED ENTERPRISE
TFEU	TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION
TEU	TREATY ON EUROPEAN UNION OF 1992
UEMOA	WEST AFRICAN ECONOMIC AND MONETARY UNION
UK	UNITED KINGDOM
UN	UNITED NATIONS
UNCTAD	UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
US	UNITED STATES OF AMERICA
USSR	UNION OF SOVIET SOCIALIST REPUBLICS
VEBA	VEREINIGTE ELEKTRIZITAETS- UND BERGWERKS AKTIENGESELLSCHAFT
VIAG	VEREINIGTE INDUSTRIEUNTERNEHMUNGEN AG
VW LAW	LAW ON THE PRIVATISATION OF EQUITY IN THE VOLKSWAGENWERK LIMITED COMPANY OF 21 JULY 1960
WTO	WORLD TRADE ORGANIZATION

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CHAPTER 1: INTRODUCTION AND AIM OF THIS THESIS

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1 Background to the research problem

The end of Apartheid[1] in the early 1990s also ended South Africa's economic isolation from the rest of the world economy. One consequence of this seminal moment in South Africa's history was that the South African government[2] had the opportunity and was required to create legal equality and security and to enact legislation which established accountability of each citizen including corporate citizens. In order to achieve this, South Africa's legal framework had to be completely overhauled in many legal areas. First and foremost the legal system had to be cleansed of discriminatory Apartheid laws. However, legal changes were also required to align the South African economy, that was isolated by sanctions, with global trends and to promote economic development which would be inclusive of and beneficial to all South Africans regardless of their race.

The Competition Act 89 of 1998[3] (henceforth the Competition Act) is an example of legislation which was to bring South Africa's economy in line with global developments and aimed to ensure that the South African economy is "open to greater ownership by a greater number of South Africans".[4] The Competition Act was enacted to regulate competition amongst enterprises in a free and fair market. Its purpose is to promote and maintain competition within South Africa.[5] Sutherland and Kemp state that:

> "Competition law concerns economic competition in free markets. It is an aspect of a government's competition policy, that is of the policy regarding the structures within and the processes by which competition takes place."[6]

[1] For comprehensive reading on the end of Apartheid see D Welsh *The Rise and Fall of Apartheid* (2009).
[2] The terms "government" and "state" are used interchangeably throughout this study.
[3] See D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) for a comprehensive discussion on the prior governmental talks and actions which ultimately culminated in the Competition Act.
[4] See the Preamble of the Competition Act.
[5] See Section 2 of the Competition Act.
[6] P Sutherland & K Kemp *Competition Law of South Africa* (2017) para 1.1.

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Lewis also highlights the importance of competition law when he states that competition law keeps markets as open as possible by guarding against collusion, anticompetitive mergers and dominant firms.[7]

It would seem that the role of state-owned enterprises (SOEs) was not carefully considered in the development of the current Competition Act. Lewis observes that initial debates regarding the post-Apartheid economy focused on "concentrated ownership" and the possibility that antitrust rules could assist the government to break up conglomerates owned by a small number of white families. He also notes that insufficient attention was paid to the role of SOEs as an integral part of the South African economy[8]

Nevertheless, it was accepted from the outset that normal competition rules would apply to SOEs.[9] The Competition Act[10] applies to all economic activity within or those having an effect within South Africa with few exceptions.[11] At present there is no exact definition of what "economic activity" for purposes of the Competition Act entails and Sutherland and Kemp correctly point out that not "every activity which has economic consequences can be so described."[12] Hence, the authors are of the opinion that this needs to change and a more precise meaning needs to be developed for purposes of the Competition Act.[13] Until that moment, however, for as long as an activity by a firm has economic consequences, that activity will come within the ambit of the concept. The meaning of the notion outside of South Africa will be discussed extensively in chapter five.[14] It suffices to state at this point that

[7] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 12.
[8] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 8.
[9] P Sutherland & K Kemp *Competition Law of South Africa* (2017) para 3.2.3 and the sources referred to.
[10] For a comprehensive discussion of the enforcement of competition rules within South Africa see D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013); and P Sutherland & K Kemp *Competition Law of South Africa* (2017). The application of the Competition Act is also fully discussed in para 2 of chapter 5.
[11] See Section 3 of the Competition Act. The exceptions listed in this section are collective bargaining within the meaning of section 23 of the Constitution of the Republic of South Africa of 1996 and the Labour Relations Act No 66 of 1995; a collective agreement as defined in section 213 of the Labour Relations Act No 66 of 1995 and concerted conduct designed to achieve a non-commercial socio-economic objective or similar purpose.
[12] See para 4.4 of chapter 4 of P Sutherland & K Kemp *Competition Law of South Africa* (2017).
[13] See para 4.4 of chapter 4 of P Sutherland & K Kemp *Competition Law of South Africa* (2017).
For more reasons why perhaps a more precise meaning of "economic activity" is required see para 4.4 of chapter 4 of the aforementioned book.
[14] See para 1.1.2 of chapter 5.

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South Africa is not the only jurisdiction grappling with the exact meaning of the notion.

The Competition Act is also applicable to economic activity of the State. Section 81[15] provides that the Competition Act binds the State. As a result of section 81, the Competition Act applies to the activities of some of South Africa's SOEs[16] which are listed in the Public Finance Management Act (PFMA)[17] and operate in key industries such as aviation, telecommunications and transport.[18] Hence, SOEs are not shielded from the provisions of the Competition Act which prohibits anti-competitive behaviour. It is therefore generally as straightforward to determine whether the SOE has contravened any of the provisions of the Competition Act, which prohibit anti-competitive behaviour, as it is for any other firm. [19]

SOEs[20] such as Telkom, South African Airways (SAA) and South African Express (Pty) Limited (SA Express) are all examples of enterprises to which the Competition Act applies. All of them are juristic persons which carry on business and provide goods and services in accordance with ordinary business principles and are primarily financed from sources other than the National Revenue Fund and taxes.[21] SOEs

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[15] Section 81 and its effect are more comprehensively discussed in para 4.3.8.4 of chapter three and para 1.1(b) of chapter 5.

[16] Throughout this study the term "state-owned enterprises" will be used although government-owned enterprises are also referred to as parastatals, public entities or public enterprises. Since this study is done from a competition law perspective, commercialised SOEs and those operated in accordance with normal business practices are the focus. Therefore when reference is made to SOEs it should be understood to refer to these types of SOEs unless it is otherwise clearly stated. The very nature of state-owned enterprises known as government agencies, boards and commissions excludes them from the scope of this study. Although the discussion in the study mostly focuses on "national public entities", all recommendations that are made in chapter five of this study should be extended to "provincial public entities" and entities on municipal level as well.
The Cambridge Business English Dictionary (Cambridge University Press, 2011) abbreviates state-owned enterprises as "SOEs".

[17] Act 1 of 1999.
The PFMA and its purpose are comprehensively discussed in para 1.2.3 chapter 5.

[18] See Schedules 1 and 2 of the PFMA for a complete list of SOEs in South Africa.

[19] See *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy* [2009] 2 CPLR 379 (CT); and *Phutuma Networks (Pty) Ltd v Telkom SA Ltd* [2011] 1 CPLR 213 (CT), which state that the antitrust provisions of the Competition Act is applicable to the economic activities of the state.
See paras 1.1.2 and 3.3.5 of chapter 5 for further reference to these cases.

[20] A detailed discussion of South African state-owned enterprises follows in chapter two of this study.

[21] See section 1 of the PFMA which defines a "national government business enterprise" as an entity which:
"(*a*) is a juristic person under the ownership control of the national executive;
(*b*) has been assigned financial and operational authority to carry on a business activity;
(*c*) as its principal business, provides goods or services in accordance with ordinary business principles; and
(*d*) is financed fully or substantially from sources other than—

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such as the aforementioned ones also have private competitors within the sector in which they operate. Sappington and Sidak are therefore correct when they state that, "SOEs compete directly with private, profit-maximizing enterprises in many important markets."[22] Because of section 81, the competitors of SOEs are protected against any anticompetitive behaviour by the SOEs.

There is however one aspect relating to SOEs which is not covered by the application of the Competition Act but may have a significant impact on free and fair competition and can be of big concern for private competitors of SOEs. Due to their ownership and mandates, SOEs including the ones which perform economic activities may rely on the financial backing of the state. Their ownership and mandates entitle them to enjoy privileges which their private counterparts do not have. These privileges include (i) monopoly power, (ii) credit guarantees, (iii) freedom from paying investors an expected rate of return, (iv) exemption from bankruptcy, (v) tax exemptions, (vi) direct subsidies, and (vii) immunity from antitrust prosecution, disclosure requirements, and other regulations.[23] The never-ending state funding of SAA on numerous occasions in order to protect the airline from financial disaster, often caused by financial mismanagement and poor governance, is a perfect illustration of the privileges enjoyed by SOEs. The competition legislation is only applicable insofar as the economic activities of these enterprises are concerned, even though these privileges may impact just as much on the competitive process as anticompetitive behaviour does.

All these privileges may create an uneven playing field for SOEs and their private competitors that operate in favour of SOEs. This may create warped incentives. SOEs may not compete efficiently if they know that they are protected by a state sponsored safety net.[24] Not only does uncontrolled state aid to SOEs which perform economic activities impact negatively on the competitive process in the present but

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(i) the National Revenue Fund; or
(ii) by way of a tax, levy or other statutory money;"

[22] DEM Sappington & JG Sidak "Competition Law for State owned enterprises" (2003) 71(2) *Antitrust Law Journal* 479 479.

[23] RR Geddes *Competing with the Government: Anticompetitive Behaviour and Public Enterprises* (2004) xi.

[24] See V Gumede *Political Economy of post-Apartheid South Africa* (2015) 81 where the author states that "Public enterprises can be prone to laziness as they understand that government resources are able to bail them out."

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even if there is ever a decision by the government to sell its ownership of an SOE, it is likely to become a dominant privately owned business that creates a threat to competition. Hence, this study is in agreement with Ahlborn's and Berg's observation that "state aid raises competition concerns where it allows inefficient undertakings to survive artificially in a competitive market to the detriment of more efficient competitors".[25] It has therefore become important to determine whether the privileges which are enjoyed by SOEs should not be subject to scrutiny in order to bring about a level playing field between SOEs and their private competitors. In order to do so there has to be a closer look at the reasons why SOEs are part of South Africa's economy, why they are funded by the state, why their funding has become such a contentious issue and why it has become paramount to scrutinise and regulated some forms of state financial aid to SOEs. These matters are comprehensively discussed in chapters two[26] and five[27] respectively. Hence, it suffices to provide a concise position on these aspects for purposes of this chapter.

1 1 The indisputable need for SOEs in post-Apartheid South Africa

The need for the existence of SOEs in South Africa is acknowledge in this study.[28] They play an important role in the development of South Africa. SOEs are used by the state to provide pivotal services and goods which are needed for socio-economic development. In terms of the South African Constitution the state has a duty to ensure that basic services and goods are provided to all South Africans.[29] The government is further under political pressure to ensure that these services are provided. The state uses SOEs to fulfil these duties and responsibilities. The South African government's intervention in certain industries is driven by its ambition to bring positive change to the lives of South Africans. The government therefore uses

[25] C Ahlborn & C Berg "Can State Aid Control Learn from Antitrust? The Need for a Greater Role for Competition Analysis under the State Aid Rules" in A Biondi, P Eeckhout & J Flynn (eds) *The Law of State Aid in the European Union* (2004) 41 50.
[26] See para 3.3 of chapter 2.
[27] See para 2.1 of chapter 5.
[28] Chapter two will provide a broad discussion for the reasons SOEs are part of the South African economy.
[29] In terms of the Preamble of the Constitution, the Constitution is the guide to elected representatives of the people of South Africa, to "improve the quality of lives of all citizens and free the potential of each person". Rights enshrined in the Bill of Rights such as the right to adequate housing, healthcare services, sufficient food and water must be respected, protected, promoted and fulfilled by the state. See section 7-39 of the Constitution of the Republic of South Africa.

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SOEs to promote economic equality for all South Africans. It will become clear from the discussion below and the more comprehensive discussion that follows in chapter two that there are good reasons for having SOEs as part of the South African economy. Through the use of SOEs the government tries to achieve socio-economic goals. The existence of SOEs in certain sectors is thus of great importance. Ramamurti[30] notes that it is a widely held belief that private firms do things right even if they not always do the right things while SOEs are expected to both do things right and to do the right things. It is important to acknowledge that SOEs in South Africa often "do the right things"[31] and it is crucial that they do the right thing to achieve the socio-economic goals of post-apartheid South Africa. However, it is fair to remark that SOEs are not always doing things right.[32] They are often tainted by inefficiency and corruption which causes them to be less efficient than private enterprises. This also prevents them from achieving their crucial mandates such as their mandates "to do things right" or it unnecessarily increases the cost of doing the right things.

1 1 1 SOEs as past and present role players in South Africa's economy

It is also not a new occurrence for the post-Apartheid government in South Africa to be actively involved in the economy through SOEs. South Africa has a rich history of having SOEs as part of its economy.[33] This aspect is extensively discussed in chapter two[34] and it suffices to state here that SOEs were already part of the South African economy long before the dawn of democracy. Clark states that the South African state played "a growing interventionist role" after World War I in order to "deal with structural imbalances in the economy and the legitimation crisis".[35] Hence,

[30] R Ramamurti "Controlling State-owned Enterprises" in R Ramamurti & R Vernon(eds) *Privatization and Control of State-Owned Enterprises* (1991) 206 207.
[31] R Ramamurti "Controlling State-owned Enterprises" in R Ramamurti & R Vernon(eds) *Privatization and Control of State-Owned Enterprises* (1991) 206 207.
[32] See para 1.2 of chapter 5 for a discussion on the failures of governance and good financial management in South African SOEs which validates the argument that they do not always do things right.
[33] See in this regard for example: CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005); NL Clark *State Corporations in South Africa: Manufacturing Apartheid in South Africa* (1994); and H Borat, A Hirsch, R Kanbur & M Ncube *The Oxford Companion to the Economics of South Africa* (2014) 203.
[34] See para 3.3 of chapter 2.
[35] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 43.

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SOEs were already integral to the economy of the Union.[36] Moreover, according to Clark the role of SOEs became particularly visible and prominent during the Apartheid era.[37] Many of these enterprises helped to shape South Africa's economy when it was isolated from the rest of the world economy because of its policies.[38] During Apartheid SOEs such as: Eskom created independence in electricity generation and supply; Iscor produced steel to provide for the local demand; Sasol satisfied the need for gas, petrol, diesel and other liquid fuels; and Armscor made South Africa more or less self-sufficient in the manufacturing of weapons. It is therefore not surprising that SOEs continue to play a significant role in the economy of a democratic South Africa.[39] Although Sasol and Iscor, two of Apartheid's most prominent SOEs, were privatised before the commencement of the democratic dispensation,[40] little has changed in regard to the importance of certain SOEs in South Africa. Today Eskom is still the biggest and only provider of electricity and Armscor still manufactures armaments for the South African military.

1 1 2 SOEs as role players in addressing socio-economic issues in South Africa

The moral function of some essential SOEs in post-Apartheid South Africa is condensed in a statement made by Berdyaev[41] when he noted that:

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[36] The Electricity Supply Commission, today known as Eskom, was established in 1923 while the establishment of the Iron and Steel Industrial Corporation (Iscor) followed in 1928. See chapter two for a more detailed discussion of these SOEs. The Union of South Africa came into being after the unification of the two former Boer republics and the two former British colonies in May 1910. It was also referred to as "a self-governing dominion within the British Empire". See P Merrington "Masques, Monuments, and Masons: The 1910 Pageant of the Union of South Africa" (1997) 49(1) *Theatre Journal* 1 1.

[37] NL Clark *State Corporations in South Africa: Manufacturing Apartheid in South Africa* (1994) xi.

[38] Roberts and Rustomjee observes that the SOEs such as ISCOR and Sasol were "nurtured" by the Apartheid regime as these SOEs were strategically important as they prolonged the existence of the Apartheid regime. See S Roberts & Z Rustomjee "Industrial Policy under Democracy: apartheid's grown-up infant industries? Iscor and Sasol" (2009) 71 *Transformation* 50 50.

[39] The importance of SOEs as part of the South Africa economy is generally acknowledged. See D Fourie "The role of Public Sector Enterprises in the South African Economy" (2014) 7(1) *African Journal of Public Affairs* 30 30 where the author states the following: "For South Africa, SOEs are vital to the growth of the economy and in the development of the country's strategic sectors, especially energy, transport, telecommunications and manufacturing."

[40] Sasol was privatised in 1979 and Iscor was privatised in 1989. See para 1.2.1 of chapter 5 for the discussion on the impact which the privatisation of Iscor had within the market in which it operates.

[41] NA Berdyaev quoted in V Tanzi *Government versus Markets: The Changing Economic Role of the State* (2011) 1.

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> "The government exists not for turning life on earth into paradise but for preventing it from turning into a complete hell"

That is exactly what the South African government tries to achieve through its use and financing of SOEs. If it were not for SOEs, millions of poor South Africans would not have had access to certain products and services, which include affordable electricity, water and sanitation, affordable railway transport and postal services. Statistics South Africa states that 89.9 percent of households in South Africa have access to piped water, 77.9 percent of households have access to improved sanitation, 85.4 percent of households have access to electricity as an energy source[42] and postal services are provided by 1520 fully fledged branches and 702 agency points of representation.[43] These are impressive numbers considering that South Africa has such a high level of inequality and poverty and people might not always have the resources to access such services and goods. The transfer of state ownership to private owners through privatisation could threaten the delivery of these services and goods to poorer South Africans. Socially immobilised South Africans are therefore able to afford such services and goods due to the involvement of the state in the economy through its SOEs.

1 1 3 Socio-economic development

Koch[44] states that "state-owned companies that provide the backbone of an economy can be expected to help spur economic growth and development". SOEs such as Eskom and Transnet truly form the "backbone" of the South African economy because of the services and goods which they provide. In light of the continuous and growing importance of SOEs, Cyril Ramaphosa, the deputy-President of South Africa at the time and currently the President of South Africa, undertook a trip to China in 2015 to learn more on the role of SOEs in the Chinese

[42] These figures are provided by Statistics South Africa. See http://cs2016.statssa.gov.za/ (last accessed on 26 August 2019).
[43] https://nationalgovernment.co.za/entity_annual/1358/2017-south-african-post-office-(sapo)-annual-report.pdf. (accessed on 26 June 2019).
[44] S Koch "The secret to successful state-owned enterprises is how they are run" *The Conversation* (22 January 2016)
(accessible at http://theconversation.com/thesecrettosuccessfulstateownedenterprisesishowtheyrerun53118).

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economy and how South African SOEs can be used to stimulate growth of the South African economy while also addressing poverty and unemployment.[45] It is clear that SOEs will continue to be important vehicles for socio-economic development.

1 1 4 SOEs as employment creators

SOEs are not only relevant for the products and services they provide. They are also strategically positioned to create employment in South Africa with its high unemployment rate which on 4 December 2019 stood at 29 percent.[46] These enterprises also had significant roles in job creation before the democratic dispensation. Clark notes that Jan Smuts[47] created Eskom to satisfy "whites facing rural poverty and urban unemployment" and that Iscor was created for the same reasons which were "to promote industrialization and to provide jobs for whites".[48] At present SOEs are also being used to create employment.

1 2 Why there should be some degree of scrutiny and regulation of state financial aid to SOEs in South Africa[49]

It is known that state aid to SOEs, whether through recapitalisation by the National Treasury[50] or the granting of government guarantees,[51] costs the state annually

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[45] See the then-Deputy President, Cyril Ramaphosa's, address on South Africa-China State-Owned Enterprises at a Seminar, Beijing 15 July 2015" (http://www.thepresidency.gov.za/content/deputy-president-cyril-ramaphosa-address-south-africa-china-state-owned-enterprises-seminar) (last accessed on 16 March 2017).
For a comprehensive discussion on the position of SOEs in China see Y Liu "A Comparison of China's State-Owned Enterprises and Their Counterparts in the United States: Performance and Regulatory Policy" (2009) 69(S1) *Public Administration Review* S46 S46-S52.

[46] http://www.statssa.gov.za/ (accessed on 29 August 2019).

[47] Jan Smuts is the South African statesman who became first prime minster in 1919 after the death of Louis Botha but lost an election in 1924 to JBM Hertzog. See NL Clark *State Corporations in South Africa: Manufacturing Apartheid in South Africa* (1994) 60.

[48] NL Clark *State Corporations in South Africa: Manufacturing Apartheid in South Africa* (1994) 69.

[49] See para. 1 of chapter 5 for a comprehensive discussion of the reasons for the proposed extension of the application of competition law to state financing of SOEs.

[50] See for example the cash transfer which the National Treasury made in terms of section 16 of the PFMA for the recapitalisation of SAA (http://www.treasury.gov.za/comm_media/press/2017/2017070101%20SAA%20recapitalisation.pdf). The types of state aid which is regularly given to SOEs will be comprehensively discussed in chapter 5.

[51] Although government guarantees may not have an immediate effect on public funds, it still has a negative implication for public funds in the event that SOEs have to draw on the guarantees. The different government guarantees to SOEs currently in place includes the following: Eskom was provided with a R350 billion

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billions of rand. In light of the important roles of SOEs in the South African society and economy as pointed out above and the crucial governmental mandates of SOEs, it is at least tenable to argue that the granting of state aid in various forms to SOEs which operate in key industries is often required for reasons of social and economic development. SOEs might be at a disadvantage in comparison with their private competitors if state aid is not provided as they have to achieve both their pure commercial goals and deliver their governmental mandate. It is therefore unrealistic to expect the government to stop all state aid to SOEs and it is acknowledge that SOEs should be able to rely on the financial support of the state in order to deliver their mandates.

Nonetheless, even with all the crucial roles which SOEs play, it is important that these enterprises should curb their reliance on state funding as far as possible. Instead of helping to spur economic growth, at present these SOEs weigh the economy down when they require regular state financial intervention.[52]

Free and fair competition is one of the crucial driving forces behind any country's business and thus economic success.[53] State funding of SOEs may cause significant problems for competitors of SOEs as it may impact on their business operations and

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guarantee from 31 March 2017 to 31 March 2023. Eskom has used R187 billion of the R350 billion government guarantees and the National Treasury estimated that R218.2 billion will be utilised by 2016/17 year-end.
In regard to SAA the National Treasury states that "the carrier remains technically insolvent. Its going-concern status depends on state guarantees totalling R19.1 billion."
In regard to the South African Post Office the National Treasury states as follows: "Since 2014, government has granted SAPO guarantees of R4.44 billion,[..] Government reprioritised other expenditure to provide SAPO with a recapitalisation tranche of R650 million in April 2016."
In regard to the South African National Road Agency (SANRAL) the National Treasury states that "Over the medium term, government has allocated R1.2 billion to SANRAL to compensate for the reduction in the standard toll tariff on the Gauteng Freeway Improvement Project from 60c to 30c per kilometre, and the halving of monthly caps."
The position at the Passenger Rail Agency of South Africa (PRASA) follows suit. National Treasury states that "Over the medium term, the Department of Transport will provide a capital transfer of R49.3 billion to PRASA."
See the National Treasury's Budget Review (2017) 100-102
(accessible at http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf).

[52] S Koch "The secret to successful state-owned enterprises is how they are run" *The Conversation* (22 January 2016)
(accessible at http://theconversation.com/thesecrettosuccessfulstateownedenterprisesishowtheyrerun53118).

[53] What is referred to as the "German Miracle" serves as support for this observation. Erhard observed that "Competition is the most promising means to achieve and to secure prosperity. It alone enables people in their role of consumer to gain from economic progress. It ensures that all advantages which result from higher productivity would eventually be enjoyed". L Erhard *Prosperity through Competition: The Economics of the German Miracle* (1958) 1.

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further skew an already uneven playing field between SOEs and their competitors. Unrestricted and perpetual state aid to SOEs which perform economic activities is not compatible with the aims of a free and fair competitive economy. Such a position is unsustainable in a country which aims to achieve inclusive economic growth. South Africa cannot continue to have a situation where we want all enterprises to contribute to the growth of the economy on the one hand but on the other hand we allow the competitive imbalance between SOEs and private enterprises to continue regardless of the presence of internal failures of many SOEs.[54] It is therefore questioned whether unlimited government-granted privileges and immunities to SOEs, regardless of the dire circumstances relating to financial management and corporate governance, should remain the norm. This is particularly important if the SOEs operate within sectors where they have or may have private competitors. It is submitted that the correct evaluation of state aid to certain SOEs and its impact on competition has become imperative for maintaining healthy competition between all enterprises. In order for South Africa's competition laws to do exactly what it is intended to do, namely to protect free and fair competition between all enterprises regardless of ownership, South Africa needs to address the risk which is posed by unrestrained state financing of certain SOEs.

Competition spurs efficiency and competitive SOEs that are adequately disciplined by market forces will also be able to translate that efficiency to the delivery of government mandates. There accordingly is an important synergy between the promotion of competition with regard to the economic activities of SOEs and the delivery on their government mandates.

Furthermore, the dependence of SOEs on government funds diverts money away from other pressing socio-economic needs such as health care, education and social security. As a result South Africans are the biggest losers when it comes to inefficiently operated SOEs which regularly require state financial aid.

[54] State aid may contribute to failures of governance and good financial management in SOEs. These unsatisfactory situations are discussed in para 1.2 of chapter 5.

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It is therefore submitted that there can be little doubt that South Africans on the one hand have an interest in having this issue addressed and competitors of SOEs on the other hand would prefer government financial intervention that takes place in accordance with a recognised structure and with transparency. Judge Sutherland in regard to the funding of an SOE (in this case SAA) remarked that:

> "the controversy about SAA and its dependence on taxpayer funds seems to me to be a demonstrably obvious topic about which every citizen has a tangible interest to be informed. If the constitutional promise of transparency in public administration is to mean anything, then awareness of what public bodies do with the nation's money is a low threshold to demand".[55]

It is against this background that this study raises the question whether it has not become necessary for South Africa to consider the implementation of state aid control rules which will form part of its competition law framework, to protect the competitive process when state aid is granted. The "dependence on taxpayer funds" of nearly every SOE which performs economic activities, has necessitated the quest to find a solution for the potential distortive effects which state funding of SOEs may have on free and fair competition and the potential negative impact which it may have on competitors of SOEs. The solution needs to give full recognition to the need for state financial aid to SOEs under certain circumstances and be mindful of the government's prerogative to always act in the broader public interest. For this reason privatisation as an option to correct these failures with regard to SOEs is therefore eschewed. Privatisation may hamper the ability of the government to eradicate poverty and inequality. Instead this study proposes a state aid evaluation system which will promote competitive markets but will be sensitive to the public interest roles and mandates of SOEs. It is recognised though that the goals of South Africa's competition laws[56] are to control and eliminate anti-competitive practices by enterprises and to regulate mergers between enterprises and not to control state

[55] *South African Airways SOC v BDFM Publishers (Pty) Ltd* [2016] 1 All SA 860 (GJ) 882.
[56] See chapter three for a comprehensive discussion of competition policy in South Africa.

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funding as there might be certain difficulties with such a position.[57] State funding of SOEs is currently not regulated by South Africa's competition laws. But Collins[58] has correctly observed that the "necessity of state-aid regulation to effective competition law enforcement depends entirely on the goals of a nation's antitrust framework".[59]

Even if it is ambitious to believe that the South African government would subject itself to any controls in regard to its prerogative to provide state aid to SOEs, it has become imperative to determine how SOEs can become less dependent on government funding and more self-reliant. It is recognised that such an endeavour will not be without significant challenges, especially since the funding of SOEs in South Africa is a "politically sensitive" matter. However, an investigation into the possible application of state aid control rules in South Africa may assist to determine how South Africa can create more competition in sectors of the economy where there is currently no effective competition, either because of state-owned monopolies or because of the unwillingness of potential private competitors to enter a market due to the presence of an SOE which may always rely on government funding.

EU state aid rules have been described as the most sophisticated and extensive state aid control rules in the world.[60] For this reason the EU state aid control rules were chosen to serve as guidance for a possible South African equivalent. The reasons for the existence of the EU state aid control rules: why it was necessary to create a state aid control regime which regulates state aid by member states of the EU to any undertaking regardless of its ownership, will be scrutinised. Furthermore, the substance of the EU state aid control regime: its rules, its application[61] and enforcement,[62] exemptions[63] to its application and procedural[64] aspects have to be

[57] All the difficulties which may be encounter with the implementation of EU-style state aid rules in a single country such as South Africa are discussed in para 2 of chapter 5.
[58] AR Collins "Is the regulation of state-aid a necessary component of an effective competition law framework" (2005) 16(2) *European Business Law Review* 379 379.
[59] AR Collins "Is the regulation of state-aid a necessary component of an effective competition law framework" (2005) 16(2) *European Business Law Review* 379 379.
[60] M Merola "Regional Aid: Recent Trends and some Historical Background- with special focus on large investment projects" 2010 3 *European State Aid Law Quarterly* 589 589.
[61] See para 4 of chapter 4.
[62] See para 8 of chapter 4.
[63] See para 5 of chapter 4.
[64] See para 6 of chapter 4.

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comprehensively discussed.[65] For purposes of this chapter it suffices to provide a concise description of the rules and its application.

2 Regulation of state aid as part of competition law: the European Union position

2 1 A brief introduction to the EU state aid rules

The EU is a supranational institution which consists at present of 28 member states.[66] Graham has stated that:

> "…the fundamental underlying purpose of the European Union has been to create a single European market where the same conditions apply to economic transactions…."[67]

The creation of an internal market[68] was one of the core objectives of the EU.[69] The internal market is "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured".[70] This objective would not have been achieved if member states were allowed to act in ways which are not consistent with an internal market. The granting of state aid to undertakings operating within a member state's borders (hereinafter connected undertakings) was considered to be one of those measures which could have affected the realisation of the internal market. Hence, rigorous supranational policies, of which the competition policy is one, were put in place to achieve the realisation of the internal market.

If state aid by member states to undertakings were left unregulated, undertakings from other member states that are unaided would have been at a disadvantage

[65] See chapter 4.
[66] Great Britain completed its exit as an EU member state on 31 January 2020 after the British population voted during a referendum on 23 June 2016 to leave the EU.
[67] C Graham *EU and UK Competition Law* (2010) 11.
[68] The founding treaties of the European Union and some older treaties use the phrase "common market". However, in this study the phrase currently in use, which is the "internal market", will be used.
[69] C Graham *EU and UK Competition Law* (2010) 301.
[70] Article 26(2) of the Treaty on the Functioning of the European Union *Official Journal of the European Union* C326/ (2012).

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when they compete with the supported undertakings. This might have distorted competition within the internal market. Consequently state aid to undertakings which perform economic activities within the EU had to be regulated. State aid control rules became part of the regulatory responses by the EU to avoid situations where member states would give preference to connected undertakings and therewith nullify the objective of the internal market. State aid rules, which have been a crucial part of the EU competition law framework since the establishment of the first European Communities,[71] therefore apply equally to all EU member states and in the internal market[72] as if it were one country, even though each member state has its own domestic economic policies. Through the regulation of state aid, both competition between undertakings and trade between member states are protected.

2 1 1 Application of EU state aid rules[73]

The legislative basis of the EU's state aid rules is found in Articles 107-109[74] of the Treaty on the Functioning of the European Union (TFEU). Article 107(1) of the TFEU provides that:

> 'Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources *in any form whatsoever*[75] which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States be incompatible with the common market.'

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[71] The three founding European Communities which is the European Economic Community (EEC) established in 1957, the European Coal and Steel Community (ECSC) established in 1951 and the European Atomic Community (EURATOM) established in 1957 are all discussed in more detail in chapter four of this study. See para 3 of chapter 4.

[72] The internal market is described as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty on the Functioning of the European Union." See J Fairhurst *Law of the European Union* 8 ed (2010) 770.

[73] See para 4 of chapter 4.

[74] See paras 3.4 and 4 of chapter 4 for a discussion of these articles. The numbering of these articles has changed as greater integration happened and as new treaties were signed and incorporated with the founding treaties. In the European Economic Community Treaty of 1957 it was numbered as Article 92-94, and then it was changed to Articles 87-89 in the Treaty establishing the European Community (EC Treaty). Throughout this study the current numbering will be used when reference is made to these treaty articles.

[75] My emphasis.

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Fairhurst states that these articles are not concerned with the way in which the state aid is granted but how the aid granted by the state or derived from the state may distort free and fair competition between undertakings.[76] State aid as a notion is thus interpreted widely.[77] This wide interpretation was confirmed in *Banco de Credito Industrial SA (Banco Exterior de Espaqa SA) v Ayuntamiento de Valencia*[78] where the compatibility with EU law of a law providing tax exemption to certain undertakings in Spain and Greece was examined. The court said that:

> "In principle, the concept of aid must be interpreted *broadly*[79] and refers to all forms of reduced burdens on undertakings. However, the concept of aid extends further than the concept of a subsidy……. Consequently, a fiscal advantage is capable of constituting aid…."80

EU state aid rules apply to all undertakings which are engaged in economic activity[81] regardless of ownership. An undertaking is defined as "every kind of natural or legal person engaged in economic or commercial activity; it must be established in order to make a profit."[82] The Court of Justice of the European Union (CJEU) provided its interpretation of the term "undertaking" in *Hofner and Elser v Macrotron.*[83] The court defined an undertaking as follows:

> "in the context of competition law….. the concept of an undertaking encompasses every entity engaged in economic activity, regardless of the legal status of the entity and the way in which it is financed."

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[76] J Fairhurst *Law of the European Union* 8 ed (2010) 648.
[77] J Fairhurst *Law of the European Union* 8 ed (2010) 648.
[78] [1994] ECR 1-877.
[79] My emphasis.
[80] *Banco de Credito Industrial SA (Banco Exterior de Espaqa SA) v Ayuntamiento de Valencia* [1994] ECR 1-877 para 46.
[81] The concept of "economic activity" is extensively discussed in para 1.1.2 of chapter 5.
[82] J Fairhurst *European Union* 6 ed (2007) 640. See also the detailed discussion on the concept of an undertaking, including a public undertaking, in the EU in para 2.1 of chapter 2.
[83] Case C-41/90 [1991] ECR 1-1979 para 2.
This description can also be found C Graham *EU and UK Competition Law* (2010) 67.

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Therefore any member state which intends to provide state aid to an undertaking in the EU is subject to the stringent state aid rules and no aid may be allocated in an arbitrary way.

2 1 2 Enforcement of EU state aid rules[84]

Member states are required to notify the EU Commission, which is responsible for overseeing the application of Union law,[85] of any possible aid to an undertaking, with certain state aid measures being exempted from the notification requirement. Exemptions may be granted in terms of the Block Exemption Regulation,[86] the de minimis principle[87] or the aid may be exempted in terms of article 107 (2) and (3) which provide a list of state aid which is *per se* regarded as being "compatible with the internal market" and aid that "*may* be compatible with the internal market". In the event that aid is given by a member state to an undertaking without the approval of the EU Commission, the Commission has the responsibility to decide whether the aid was given in violation of the Treaty.[88] The EU Commission therefore enforces a supranational competition legislative framework which incorporates the EU state aid rules.

3 Recognising the differences between South Africa as a single state and the EU as a supranational institution

State aid rules are unique to the EU because of its composition. This study recognises the vast differences between the EU and South Africa. A detailed

[84] See para 8 of chapter 4 for a comprehensive discussion on the enforcement of EU state aid rules.
[85] See Article 17 of the Consolidated Version of the Treaty on the European Union *Official Journal of the European Union* No C 202/25 (2016).
[86] If state aid is part of a block exemption in the Block Exemption Regulation the granting of the aid has the automatic approval of the European Commission. See para 5.2 of chapter 4 for a detailed discussion on the Block Exemption Regulation.
[87] D*e minimis* aid is aid which does not exceed €200,000 per undertaking over any period of 3 fiscal years. See the Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty and Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid. See para. 5.3 of chapter 4 for a detailed discussion the *de minimis* rule.
[88] See para 6 of chapter 4.

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analysis of these differences will be undertaken in chapter 5.[89] It suffices to state here that South Africa is a rather small economy in comparison with that of the EU. Post-apartheid South Africa grapples with social and economic problems that do not arise in the EU. It is also acknowledged that there will be difficulties in transplanting supra-national EU state aid rules to a single country such as South Africa.[90] Hence, the proposals for a potential state aid control regime for South Africa that are made in this study will recognise and be strongly influenced by these enormous differences between the EU and South Africa.

Moreover, there is much to be learned about state aid to SOEs by single states,[91] if one looks beyond the EU's supranational status to some of its individual member states. Particularly important is what transpired within some eastern European countries[92] before they joined the EU in 2004. Most of these countries do not have much bigger economies than South Africa[93] and most of their economies were predominantly state-controlled via SOEs in the past as most had "centrally planned economies" with state aid as an "essential element."[94] The implementation of the EU state aid control rules was however one of the requirements for accession to the EU.[95] The EU Commission managed to ensure that these countries complied with the state aid rules without significant transitional problems. This was mainly because they were required to have measures in place before accession, to ensure that there would be compliance with the state aid rules on accession.[96] Hence, these countries

[89] See para 2.2 of chapter 5 for a discussion of the supranational status of the EU as one potential impediment to the application of state aid rules in South Africa as a single state.
[90] These difficulties are comprehensively discussed in para 2 of chapter 5.
[91] In this regard reference can also be made to the future UK state aid control regime which will be implemented in terms of the "State Aid (EU Exit) Regulations 2019" after the UK leaves the EU. The position on state aid in the UK after it exit the EU is comprehensively discussed in para 4.3.7.3 (a)
Ukraine is another single state where a state aid control regime applies. In terms of the Association Agreement between the EU and Ukraine which is in effect since September 2017 and replaced the Partnership and Cooperation Agreement of 1998 between the EU and Ukraine, Ukraine as a third country was required by the EU to implement a domestic state aid control system which replicates the position in the EU
[92] This includes for example countries such as Poland, the Czech Republic, Hungary, Romania and Bulgaria
[93] See for example A Lester, E Nel & T Binns *South Africa Past, Present and Future: Gold at the end of the Rainbow* (2014) 283 where the authors found some "interesting similarities" between South Africa and Poland and place South Africa "well above" Romania when considering the per capita GNP.
[94] See J Hoelscher, N Nulsch & J Stephan "State Aid in the New EU Member States" (2017) 55(4) *Journal of Common Market Studies* 779 779.
[95] See P Schitterle "Implementing of the EC State Aid Control - an Accession Criterion" (2002) 1(1) *European State Aid Law Quarterly* 79 79–86.
[96] See J Hoelscher, N Nulsch & J Stephan "State Aid in the New EU Member States" 2017 55(4) *Journal of Common Market Studies* 779 781-782.

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adopted national state aid laws and their own authorities were monitoring the enforcement of their state aid laws.[97] Schitterle[98] states that in accordance with the European Agreements concluded between these eastern European countries and the EU at the time, the EU state aid rules were supposed to be implemented by 31 December 1997. Even though they only implemented the rules in 2001,[99] the important point is that these countries, all with former "centrally planned economies", managed to do so successfully long before accession in 2004. This relatively smooth transition and compliance with the EU state aid rules by countries which had "centrally planned" economies and high levels of state intervention in their economies show:

(i) that single state status is not necessarily an impediment to the implementation of state aid rules;

(ii) that even in countries where SOEs were prevalent and assumingly regularly getting state aid due to their ownership, state aid rules could be implemented effectively; and

(iii) that the implementation of state aid control rules does not necessarily take away the state's ability to intervene in the economy but the state would do so in accordance with a set of rules which not only protects all economic competitors but also helps to grow the economy. It therefore does not take away the state's ability to achieve governmental aims by using SOEs since state aid is still allowed for public interest reasons.[100] The important aim it achieves though is to ensure that state aid is not distorting competition which is important for economic growth.

As full member states of the EU, these eastern European countries have no choice but to comply with the state aid rules and it appears as if they continue to do so as there are no out of the ordinary complaints against them for providing unlawful state aid. They seem to act as they are required to do by the state aid rules and in the

[97] See J Hoelscher, N Nulsch & J Stephan "State Aid in the New EU Member States" 2017 55(4) *Journal of Common Market Studies* 779 781-782.

[98] P Schitterle "Implementing of the EC State Aid Control - an Accession Criterion" (2002) 1(1) *European State Aid Law Quarterly* 79 80.

[99] See para 2.2 of chapter 5 for a discussion on the challenges which national monitoring authorities faced while having to enforce a national system of state aid control. These challenges could have played a role in the delayed implementations of the rules.

[100] See the discussion in para 7.2 of chapter 4 on Services of General Economic Interest (SGEI) in the EU and the discussion in para 3.2.3.1 on subsidisation of particular activities through national and provincial budgets in South Africa.

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exact same way as all other member states do. The analogy between South Africa and these eastern European countries should not be taken too far: despite the priority given placed on SOEs, the South African economy was never centrally planned, the fall of communism in eastern Europe meant that the ideological context within these countries were quite different from South Africa and although these states were still independent when they imposed state aid rules, they were influenced to do so by the dangling carrot of EU membership. However, this development still shows that the supranational nature of the EU state aid rules does not automatically disqualify it for consideration in a single state.

4 RATIONALE FOR THE STUDY

This study was prompted by the uncontrolled state funding to SOEs which have or may have private competitors, even while these enterprises are governed and managed in ways which are below the minimum standard of good governance and management required by different legislation. Unlimited and perpetual state aid to poorly governed and financially mismanaged SOEs has significant consequences in South Africa.

First, it reduces government funding which is available for other developmental purposes such as education and health care as funds need to be injected into these enterprises regularly. The National Treasury stated in its 2017 Budget Review[101] that "operational inefficiencies, poor procurement practices, weak corporate governance and failures to abide by fiduciary obligations have plagued several companies that are now in serious financial difficulty." The unabated spending of public money on a number of SOEs, notwithstanding poor governance[102] and financial mismanagement should be of concern to all South Africans since poor governance and financial mismanagement keeps certain SOEs permanently dependent on government funding. This on its own requires an investigation into options to make SOEs less reliant on government funding. The growing discontent with this form of state aid

[101] Chapter 8 of the 2017 Budget Review (accessible at http://www.treasury.gov.za/documents/national%20budget/2017/review/Chapter%208.pdf).
[102] See A Thomas "Governance at South African state-owned enterprises: what do annual reports and the print media tell us?" (2012) 8 *Social Responsibility Journal* 448 448-470.

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illustrates the urgent need for an investigation into more effective regulation of this form of aid.[103] National news headlines such as "Parastatals weigh on SA's future", "SAA[104] and the R550-million bailout", "Pension-fund bailout for Eskom", "SOEs drag SA to the state of junk"[105] and "Parastatals bailed out again-with promises of a fix" are a regular occurrence in the South African media.

Second, state funding of SOEs have the potential to distort free and fair competition in South Africa because many SOEs have private competitors or potential competitors. This potential distortive effect of state funding of SOEs is the main focus of this study and it was undertaken as a result of the negative impact which state aid to SOEs may have on the competitive process. Hence, the intention is to find a way to address the possible distortive effects of the state funding of SOEs. This requires an investigation into possible measures which could protect private competitors of SOEs against measures that create an uneven playing field without taking away the government's ability to grant financial aid to SOEs where appropriate. State aid control rules were identified as one potential measure that could achieve this. This study thus attempts to find a middle way that balances the protection of the competitive process against the distortive effects which state aid to SOEs may have and the state's prerogative to provide state aid to SOEs in order for them to execute their governmental mandates. Although the focus of this study is to find a solution for the potential distortive effects which state funding of SOEs may have on the competitive process, such a solution would directly have a positive impact on the

[103] See SM Muller "South Africa needs to sober up to save itself from sickly state-owned enterprises" *The Conversation*. Muller supports the fact that drastic steps need to be taken to address the issues in South Africa's SOEs.
(https://theconversation.com/south-africa-needs-to-sober-up-to-save-itself-from-sickly-state-owned-enterprises-83822) See also J Rossouw "South Africa must free itself from the burden of owning a national airline" *The Conversation*
(https://theconversation.com/south-africa-must-free-itself-from-the-burden-of-owning-a-national-airline-64004) and
M Mutize & S Gossel "Corrupt state owned enterprises lie at the heart of South Africa's economic woes" *The Conversation*
(https://theconversation.com/corrupt-state-owned-enterprises-lie-at-the-heart-of-south-africas-economic-woes-79135).

[104] The courts have also noticed the public scrutiny which SAA as an SOE has been subjected to. Justice Sutherland in *South African Airways SOC v BDFM Publishers (Pty) Ltd* 2016 (2) SA 561 (GJ) 565 said "SAA is a public company and an organ of state whose financial affairs have been the subject of intense public interest and media scrutiny for several years, in which its viability as a going concern has been the main theme together with the financial support given to it by the state."

[105] See the Financial Week (29 September 29 2016).

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funds which are available for other developmental issues and would promote the efficient execution of government mandates as competition promotes the efficiency of enterprise.

Third, SOEs such as SAA in the past frequently appeared before the South African competition authorities for violations of the existing competition laws.[106] Currently the competition laws do not address the root cause of this impunity. Unrestricted state aid strengthens the market power of SOEs and isolates them from feeling the pinch of high fines and damages claims.[107] Effective enforcement of conventional competition law may require consideration of state aid regulation.

5 RESEARCH QUESTIONS

The primary research question of this study is whether the regulation of state funding of SOEs which have or may have private competitors may prevent or significantly limit the potential distortion of competition by such state funding. In order to answer this question, it is necessary to know what the purpose and aims of South Africa's competition legislation is and when it applies. It must then be established whether state aid to SOEs is of such a nature that, under certain circumstances, the application of South African competition laws should be extended to include it.

A secondary question is whether and to what extent South Africa could benefit from a state aid control regime guided by the EU state aid control rules considering the many differences between South Africa and the EU.

6 HYPOTHESIS

The main hypothesis of this study is that unregulated state aid to SOEs which have or may have private competitors distorts competition in the absence of a proper regulatory framework. Free and fair competition amongst all enterprises, regardless of its ownership, is crucial for economic development which ultimately benefits all

[106] See for example *Competition Commission v South African Airways (Pty) Ltd* [2005] 2 CPLR 303 (CT); and *Competition Commission / Deutsche Lufthansa AG; South African Airways (Pty) Ltd* [2006] 2 CPLR 528 (CT)
[107] See the discussion in para 1.1.3 of chapter 5.

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South Africans. Unlimited state financial aid to SOEs is a significant threat to competitors and potential competitors, which in turn undermines the competitive process. State aid to SOEs without any clear criteria or legislative guidelines may lead to a diminished competitive drive of SOEs. SOEs will be able to produce products at competitive prices without being efficient because losses will be covered by state support. Other firms may be reluctant to enter markets dominated by SOEs that receive state grants even if they do not produce products at competitive prices. Inefficient behaviour of SOEs may be particularly harmful as it will hamper their ability to contribute to broader socio-economic goals. Ineffective state aid will mean that scarce state funds will not be applied effectively.

The ordinary rules of competition law are not sufficient to ensure a level playing field between SOEs and their private competitors as these rules only apply to anti-competitive behaviour by SOEs which perform economic activities, new measures need to be explored. It has become crucial for South Africa to address this problem in order to ensure economic growth for the benefit of all South Africans.

7 OBJECTIVES AND METHODOLGY

7 1 Objectives

This study highlights one of the significant threats to free and fair competition by identifying the potential distortive effects which unconstrained state aid to SOEs, may have on the competitive process in South Africa. Hence, the overall and main objective of this study is to have certain state aid[108] to SOEs evaluated by the competition authorities of South Africa. It therefore seeks to identify important lessons from the EU's state aid control rules which can be applied in the pursuance of a domestic state aid control regime.

This study furthermore seeks to propose measures that balance the need for competitive markets and the crucial developmental and socio-economic role that is

[108] The State aid which possibly should be subjected to evaluation by the competition authorities is discussed in para 5.2 of chapter 5.

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envisaged for SOEs in South Africa. Without some state aid SOEs will not be able to compete effectively while at the same time fulfilling their public mandates. It is unlikely that the government will completely give up its sovereign powers to use state aided corporations to achieve policy goals. The proposals that are made here are sensitive to this reality.

7 2 Methodology

To achieve these objectives, this study considers a wide ranging number of topics:
(i) the history and development of SOEs and the justifications for their continuous existence;
(ii) the origin of statutory competition law, in the three chosen EU jurisdictions and South Africa and its application to SOEs;
(iii) the EU state aid control rules; and
(iv) the potential distortive effect which state aid to SOEs has within South Africa's competitive environment and how it can be ameliorated.
Scholarly work from the disciplines of political science, economics and law will be considered. The legal areas of competition law, state aid law, the law on corporate governance and state owned enterprises, domestic and international, as well as statutory material relating to these areas are at the centre of all these investigations.

The part of the study which examines EU state aid rules and its relation to competition focuses on EU primary and secondary sources. These sources include the provisions of the various EU treaties which deal with state aid, directives, regulations and decisions on state aid issued by the EU Commission, case law on state aid and competition law by the CJEU and the input by the national competition authorities of the member states of the EU.

The part of the study which examines SOEs in South Africa and the role of South African competition law in regard to these enterprises will encompass a variety of sources. These include wide ranging scholarly work, competition legislation and policies, the enabling legislation dealing with the operations of SOEs, other statutes which deal with SOEs and relevant decisions by the Competition Commission, the Competition Tribunal, the Competition Appeal Court and other superior courts which

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include the provincial divisions of the High Court, the Supreme Court of Appeal and the Constitutional Court.

The part of the study which examines competition regulation in three of Africa's leading regional economic communities (ECOWAS, SADC and COMESA) to determine whether it is possible to pursue a state aid control regime for the regional economic community of which South Africa is a member state, draws on wide ranging scholarly work and primary sources such as their founding treaties, declarations, agreements and memoranda of understanding between member states of these institutions.

8 OUTLINE OF THE STUDY

8 1 Chapter two

This chapter commences with an exploration of the origin of SOEs, their nature and the role and continuous use by governments of SOEs. The rise and fall of SOEs within selected EU member states are discussed. The purpose of this discussion is to show that SOEs were also crucial market players in those countries which are today known as developed countries before free and fair competition between private firms became the driving force for economic growth. For purposes of this discussion, the position on SOEs in Germany, France and Great Britain since the end of World War II is scrutinised. The reasons for selecting these countries for discussion are set out in chapter two but most important is that they are all currently members of the EU which has the world's only state aid control regime as a crucial part of its competition law. This discussion reveals the differences in how these countries have used state-ownership, if at all, to rebuild their economies after World War II. The discussion on the use of SOEs as market players by states will also demonstrate how individual countries use SOEs for different purposes.

Chapter two concludes with a discussion of the most significant South African SOEs before and after the dawn of democracy, their role within the South African economy and the measures that were taken to make SOEs in South Africa more efficient and effective.

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8 2 Chapter three

This chapter provides an exploration of the purpose and function of competition law and its relevance for SOEs. It discusses what competition law is and why it is important. The discussion starts with a historical overview of economic competition. It then proceeds with an analysis of competition law as a measure to protect competition. The birth of modern-day competition law in the United States of America and its applicability to SOEs are scrutinized. Chapter three continues with a discussion of the statutory competition law within the EU and its implementation within the three selected jurisdictions: France, Germany and Great Britain. The chapter concludes with a discussion of statutory competition law in South Africa.

8 3 Chapter four

Chapter four scrutinises state aid regulation in the EU. It investigates how the regulation of state aid helps to promote competition among enterprises by scrutinising the inception of the state aid rules and why it was necessary for the newly established European Coal and Steel Community (the ECSC) and the European Economic Community (the EEC) after World War II to have such rules in place. Both the substantive and the procedural rules of the EU state aid control regime are scrutinised. This discussion provides clarity on the need that is fulfilled in the EU by state aid control rules. The chapter also provides a discussion on the enforcement of EU state aid rules and the exemptions from these rules. The chapter concludes with a discussion of state aid control outside of the EU with a focus on the United States of America and the World Trade Organization (the WTO).

8 4 Chapter five

Chapter five sets out the reasons why it is argued that state aid control rules in regard to certain state aid and certain SOEs are needed in South Africa, as a single state. The extent to which South African competition law is currently applicable to SOEs and the regulatory gaps in the current regime are discussed. The chapter sets out the benefits and difficulties with state aid rules for South Africa as a single state. Since South Africa is a member state of the Southern African Development

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Community (SADC), it necessitates a discussion of the competition rules within SADC, as this discussion stipulates the reasons why the proposals made within this study are made for South Africa as a single state and not as a member of SADC. For purposes of comparison, the competition rules within the Common Market for Eastern and Southern Africa (COMESA) and the Economic Community of West African States (ECOWAS), two other African regional economic communities, are also scrutinised. The chapter concludes with a proposal regarding the entities and the forms of state funding to which state aid rules should be applied and the role which the South African competition authorities should play in evaluating state aid which may have a potential harmful effect on competition.

8 5 Chapter six

This chapter provides a summary of the outcomes of this study. It sets out why South African policymakers should give serious consideration to the implementation of a state aid control regime. It then sets out how such regulatory regime should look. Finally, the chapter concludes with a draft set of regulations that could be considered by the government as a possible legislative solution to the threat posed by state aid to free and fair competition, the wider economy and the developmental goals of the government.

END OF CHAPTER

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CHAPTER 2: STATE-OWNED ENTERPRISES AND THEIR DEVELOPMENT IN THE RELEVANT JURISDICTIONS

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1 Introduction

SOEs[1] play a pivotal role in the economies of many countries all over the world. During a data collection exercise by the Organization for Economic Development (OECD) in 2011 on the amount of SOEs within its member states, it was established from the information submitted by some member states[2] that 2057 SOEs operate within those member states who have submitted data.[3] It is therefore submitted that SOEs still play a role even in the economies of developed countries although state intervention in these countries has declined significantly during the 1980s and 1990s.[4]

South Africa also has many SOEs across many strategically important sectors of the economy which provide services and goods to the South African public.[5] SOEs can be found in sectors such as transport, telecommunications, electricity supply and manufacturing.

It is known that the presence of SOEs in markets may impact on competition within those markets. This is because SOEs are frequently dominant in their sectors and thus make the entry of a competitor into that sector difficult and/or there are competitors in the sector but SOEs, due to their state-ownership, enjoy the added advantage of possible government financial assistance or state aid which could have a distortive effect on competition. The granting of state aid to SOEs could mean that

[1] Different synonyms are used to refer to state-owned enterprises. Terms such as "parastatal", "state-owned corporations", "public enterprises", "state-owned companies", "public entity" and "public company" are widely used in the literature on these institutions. In this study the term state-owned enterprises will be used throughout.
[2] The OECD has currently 34 member states of which 27 state submitted sufficient data in order to compile a report of the amount of operable state-owned enterprises within these countries.
[3] See H Christiansen *The Size and Composition of the SOE Sector in OECD Countries OECD Corporate Governance Working Papers No 5* (2011) 1 6 (accessible at http://dx.doi.org/10.1787/5kg54cwps0s3-en).
[4] PA Toninelli (ed) *The Rise and Fall of State-owned Enterprises in the Western World* (2000) ix.
[5] The Department of Public Enterprises is the responsible ministry for state-owned enterprises in South Africa although there are some SOEs which are under the oversight of other ministries. These include the Department of Energy which has oversight over PetroSA, the Department of Communications which is responsible for the SABC and the Department of Transport, which has oversight over SOEs such as PRASA and the South African National Road Agency (SANRAL). Until recently the troubled SAA was also overseen by the Department of State-Owned Enterprises. This however changed when the national airline was transferred to the oversight of the National Treasury. It is the only SOE which is directly overseen by the National Treasury.

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the "competitive neutrality" principle is either not applied or its application is watered down. In terms of this principle SOEs and private enterprises should enjoy a "level playing field".[6] According to the OECD the "competitive neutrality principle" can be applied by having policies in place which ensure that the same rules apply to both private and state-owned enterprises. This would culminate in a limited role for the State and more competitive markets.[7] To understand how state financial aid[8] to SOEs may distort competition, it is necessary to know what SOEs are and the characteristics that are intrinsic to these enterprises. This discussion will recognise the importance of the role which SOEs played and still play in assisting states to develop certain industries to the benefit of all its citizens. Hence this chapter provides (i) an overview on the nature and characteristic of SOEs and their role within a market economy; (ii) the reasons for the continuous use of SOEs by governments; (iii) the origin of SOEs from their heydays in the 1960s; (iv) the modern decline of SOEs in Western economies and the reasons for the decline; and (v) the role of SOEs in South Africa.

The Western economies chosen for study in this chapter are Britain, Germany and France. Firstly, Germany and France are and will remain members of the EU while Britain has decided to leave the EU but it will remain closely associated with the EU. As indicated in chapter one, the discussion in chapter five on how to control state aid to SOEs in South Africa uses the EU's state aid control model as a benchmark because it is the only institution which applies a comprehensive state aid regulatory model as part of its competition law framework. Secondly, European integration started with France and Germany since they were the first two countries whose coal and steel industries were placed under the authority of one institution after World War II. This institution became known as the European Coal and Steel Community[9] and it was one of the first European communities which applied state aid control

[6] For more on the competitive neutrality principle see OECD *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business* (2012). This term is widely used in literature which deals with competition between state-owned enterprises and private enterprises. See for example also A. Capobianco & H Christiansen *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options OECD Corporate Governance Working Papers No 1* (2011) (accessible at http://dx.doi.org/10.1787/5kg9xfgjdhg6-en).
[7] OECD *State Owned Enterprises and the Principle of Competitive Neutrality* (2009) 37. (accessible at https://www.oecd.org/daf/competition/46734249.pdf).
[8] EU state aid control rules are discussed in chapter 4 and state aid to SOEs in South Africa and its impact on competitors of the SOEs are discussed in chapter 5.
[9] J Fairhurst *Law of the European Union* (2010) 5.

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rules. The treaty establishing this community forms the start of European integration. Thirdly, Germany and France are also chosen since these two countries have the biggest economies in continental Europe. Fourthly, a discussion SOEs in Britain is justified as the divestiture of these SOEs during Margaret Thatcher's time as Prime Minister was admired throughout the world and all literature today that deals with privatisation of SOEs includes Britain as part of the discussion. This is especially significant as Britain became one of the leading industrialised nations after World War II. In France the decline of SOEs started when Jacques Chirac became the Prime Minister in 1986. In Germany the decline commenced immediately after World War II during Konrad Adenauer's administration. Adenauer was the first post-war Chancellor of Germany and he is considered to be the first Western leader after the war to start a divestment programme even though Margaret Thatcher's privatisation programme is considered to be historically the most important one.[10] A more detailed discussion on SOEs and their decline within the abovementioned three countries follows later in the chapter.

The chapter concludes with a discussion of the position in regard to SOEs in South Africa, since this study is done from a South African perspective. Also, South Africa is a leading economy on the African continent. It still has many SOEs which are granted state aid and there seems to be no reasonable indications that this position will change soon.

1 1 Nature and characteristics

Descriptions of SOEs can be found in a wide-ranging literature and case law as well as in several pieces of legislation worldwide.[11] Gillis states that the "label" of state-

[10] WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 323.

[11] Coombes states that: "public corporations are like joint stock companies in that they are separate legal entities which can sue and be sued in courts, which keep commercial accounts, and which hire and fire their own staff. Public corporations are not directly accountable to Parliament (or thereby to the electorate), their staffare not members of the Civil Service, and they do not need parliamentary approval before spending money as does a government department. They are not headed by a minister but by a board of independent members appointed on the basis of their qualifications. However ministers (who are accountable to Parliament) may possess statutory powers over public corporations." See D Coombes *State Enterprise Business of Politic?* (1971) 22. Nellis defines SOEs as: "government owned or controlled entities which are supposed to earn the bulk of their revenues from sales, have a distinct legal identity, and are self-accounting." See JR Nellis, *Public Enterprises in*

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owned enterprise means different things to different people.[12] It is therefore important to identify those characteristics that distinctively make an enterprise an SOE. The OECD states that most countries may define SOEs as those enterprises in which the state holds the majority of voting shares.[13] It identifies however also those instances in which the state is not the majority owner but still exercises a "similar degree of control" over the enterprise.[14] In the light of this, it is submitted that the most important characteristic of SOEs is that they are either wholly or partially owned or controlled by a state. Their government ownership or control entitles SOEs to a number of advantages which clearly distinguish them from private enterprises. These advantages include that:

> "They are under less pressure to pay dividends.
>
> They have implicit government backing and can thus raise debt capital more readily.
>
> They have preferential access to state financing.
>
> They receive more or less distinguished subsidies or outright grants.
>
> They have a quasi-captive market at home.
>
> They enjoy preferential procurement conditions"[15]

Beside their government ownership, many[16] SOEs are considered to be "hybrid organization(s)". This is because they also sell their output to the general public which makes them economic participants and bring them within the ambit of the

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Sub-Saharan Africa World Bank Discussion Papers (1986) vii. SOEs are also described as those enterprises "effectively controlled by the government, those in which the state owns a majority of equity." See R Mazzolini, "Are State-Owned Enterprises Unfair Competition?" (1980) 23(2) *California Management Review* 20 20.

[12] M Gillis "The Role of State Enterprises in Economic Development" (1980) 47(2) *Social Research* 248 251.

[13] OECD *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?*(2016) 18 (accessible at http://dx.doi.org/10.1787/9789264262096-en).

[14] OECD *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* (2016) 18 (accessible at http://dx.doi.org/10.1787/9789264262096-en).

[15] See R Mazzolini "Are State-Owned Enterprises Unfair Competition?" (1980) 23(2) *California Management Review* 20 20.

[16] In a South African context only the commercialised SOEs and those operated in accordance with normal business principles are of a hybrid nature. All others public entities listed in the schedules to the PFMA are public entities with no commercial activities but which deliver pure public responsibilities.

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market.[17] Hence scholars also pay particular attention to the competitive nature of SOEs. Sappington and Sidak[18], for example, state that:

> "State-owned enterprises (SOEs), also known as public enterprises, are owned by governments rather than by private investors. SOEs compete directly with private, profit-maximizing enterprises in many important markets."

The authors' observation regarding direct competition with private enterprises is important for purposes of this study since such direct competition by financially assisted SOEs causes many challenges[19] to their private competitors.

In the context of South Africa, SOEs are referred to in a variety of ways which include "parastatal", "public entities", "state-owned companies" and "public enterprises". Reference to entities which are fully or partially owned or controlled by the state can be found in many statutes because South Africa does not have one particular statute dedicated to SOEs.[20] The Broad-Based Black Economic Empowerment Act 53 of 2003, the PFMA and the Companies Act 71 of 2008 (the Companies Act) are a few of the more important examples. Because there is no dedicated Act, there is no general definition of SOEs. The most important

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[17] LP Jones *Public enterprise in less developed countries* (1982) 1. See also R Ramamurti "Controlling State-owned Enterprises" in R Ramamurti & R Vernon (eds) *Privatization and Control of State-Owned Enterprises* (1991) 206 207.

[18] DEM Sappington & GJ Sidak "Competition Law for State-owned enterprises" (2003) 71(2) *Antitrust Law Journal* 479 479. See also OECD *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* (2016) (accessible at http://dx.doi.org/10.1787/9789264262096-en).

[19] The advantages enjoyed by SOEs place these enterprises in a more beneficial position than their private competitors. It may also reduce any effort by SOEs to compete freely and fairly with their privately-owned counterparts. See for example R Mazzolini, "Are State-Owned Enterprises Unfair Competition" (1980) 23(2) *California Management Review* 20 20-28.

[20] Countries have adopted different legislative approaches when dealing with SOEs. While reviewing various legislative structures on SOEs it became apparent that countries either have one comprehensive statute which deals with all SOEs generally or a general statute dealing with SOEs plus individual statutes for each SOE or only individual statutes dealing with a particular SOE and its operations. New Zealand, Australia and Namibia are examples of countries which have one specific statute which deals with the governance of SOEs in general. Australia has the Public, Governance and Accountability Act 123 of 2013 which distinguishes between two types of Commonwealth entities, a corporate Commonwealth entity which is a body corporate and non-corporate Commonwealth entity, which is a Commonwealth entity but not a body corporate. See section 11 of Public, Governance and Accountability Act 123 of 2013. New Zealand has the State-Owned Enterprise Act 1986 which lists all SOEs in Schedule 1. State-owned enterprises in the New Zealand statute includes, inter alia, enterprises such as Airways Corporation of New Zealand Limited, Asure Quality Limited, Electricity Corporation of New Zealand Limited, New Zealand Post Limited, New Zealand Railways Corporation and Transpower New Zealand Limited. Namibia has the State-owned Enterprises Governance Act No. 2 of 2006.

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categorization of public entities is found in the PFMA. Most importantly it refers to national[21] government business enterprises which are described as a form of a "national public entity" together with:

> "(*b*) a board, commission, company, corporation, fund or other entity (other than a national government business enterprise) which is—
> (i) established in terms of national legislation;
> (ii) fully or substantially funded either from the National Revenue Fund, or by way of a tax, levy or other money imposed in terms of national legislation; and
> (iii) accountable to Parliament."[22]

A "national government business enterprise" in turn is described as an entity which:

> "(a) is a juristic person under the ownership control of the national executive;
> (b) has been assigned financial and operational authority to carry on a business activity;
> (c) as its principal business, provides goods or services in accordance with ordinary business principles; and
> (d) is financed fully or substantially from sources other than—
> (i) the National Revenue Fund; or
> (ii) by way of a tax, levy or other statutory money."[23]

The Companies Act defines a "state-owned company" as

> **"**an enterprise that is registered in terms of this Act as a company, and either—
> *(a)* is listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act, 1999 (Act No. 1 of 1999); or

[21] It also has a definition of a "provincial public entity". See section 1 of the PFMA.
[22] Section 1 of the PFMA.
[23] Section 1 of the PFMA.

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> *(b)* is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000), and is otherwise similar to an enterprise referred to in paragraph (a)"[24]

The recognition of SOEs in the Companies Act is a seminal development because the Companies Act 61 of 1973 (1973 Companies Act) did not deal specifically with SOEs. By specifically regulating SOEs, it is recognised that they sometimes require unique treatment, even though many general company law principles that apply to other companies will also apply to them.

Since the EU's state aid control rules serve as the yardstick to determine how state aid to certain SOEs in South Africa could be controlled, it is appropriate to look at those characteristics ascribed to SOEs in the EU. In the EU, the term "undertaking" is used to refer to enterprises which conduct business activities in business, whether public or private. Graham[25] defines an undertaking in the context of competition law as:

> "The concept of an undertaking encompasses every entity engaged in an economic activity regardless of the legal status of the entity and the way in which it is financed."

This is a rather wide definition which encompasses the activities of any economically active undertaking, private or public and therefore includes the economic activities of SOEs or public undertaking, as SOEs are called in the EU. Public undertakings are defined in the European Commission's directive on the transparency of financial relations between member states and public undertakings[26] as:

[24] Section 1 of the Companies Act 71 of 2008.
[25] C Graham *EU and UK Competition Law* (2010) 67.
[26] Commission's Directive No. 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings.

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> "any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it.
>
> A dominant influence on the part of the public authorities shall be presumed when these authorities, directly or indirectly in relation to an undertaking:
>
> (a) hold the major part of the undertaking's subscribed capital ; or
>
> (b) control the majority of the votes attaching to shares issued by the undertakings; or
>
> (c) can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body."[27]

This description of "public undertakings" was reaffirmed by the CJEU in *France, Italy, and the United Kingdom v Commission*[28] when it addressed the meaning of the term "public undertaking".[29] Public undertakings were described as enterprises over which a public authority[30] may exercise directly or indirectly a dominant influence.[31] It is stated that influence is presumed "when the public authority directly or indirectly holds the major part of the undertaking's subscribed capital, control the majority of votes, or can appoint more than half of the members of its administrative, managerial or supervisory body".[32] A public undertaking in the EU is thus comparable to an SOE in South Africa.

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[27] See Article 2 of the Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Union* No L 318/17 [2006]. The description was initially introduced by Commission's Directive No. 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings *Official Journal of the European Communities* No L 195/35 [1980].

[28] *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission of the European Communities* [1982] ECR 2545.

[29] *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission of the European Communities* [1982] ECR 2545. See also P Graig & G De Burca *EU LAW Text, Cases and Material* 3rd ed (2003) 1124.

[30] A public authority is described as the State, regional, local and all other territorial authorities. See Article 2 of the Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Union* No L 318/17 [2006].

[31] *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission of the European Communities* [1982] ECR 2545. See also P Graig & G De Burca *EU Law Text, Cases and Material* 3rd ed (2003) 1124.

[32] P Graig & G De Burca *EU Law Text, Cases and Material* 3rd ed (2003) 1124.

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1 2 Introduction to the reasons why governments utilise SOEs

The rationales for using SOEs differ from country to country. Clark states that "state enterprises have been employed by almost every imaginable type of government for a wide variety of reasons."[33] The continuous use of SOEs should thus be viewed from the country's perspective. Aikins is of the opinion that both "the market system and government intervention have their strengths and weaknesses, but their mutual coexistence is necessary for society".[34] Hence a one-size- fits -all approach cannot be followed to argue for less or more state intervention in the economy of an individual country.

SOEs are one of the instruments for government intervention in markets. It must therefore be asked why government would intervene in markets and more particularly why they would prefer to make use of SOEs over other forms of intervention[35] such as taxes, regulation and informal administrative guidance.

The literature provides a wide range of reasons for governments creating or retaining SOEs to intervene in the economy including: "developmental goals", "potential market failures", that the state has contracted with the private sector for the provisions of services and goods and the desired position is not achieved, "regulatory deficiencies" and "political economic issues".[36] Cuervo-Cazurra and others argue that there are two "traditional explanations" for the existence of SOEs and these are the "economic" reason and the "political" reason.[37] In accordance with the economic reason, governments use state- ownership to correct market failures and hence choose to become the "provider of goods to society" by using SOEs.[38] In accordance with the political reason, the "ideology and political strategy" of the government may result in the creation of SOEs if the government is not sufficiently

[33] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 2.
[34] SK Aikins "Political Economy of Government Intervention in the Free Market System" (2009) 31(3) *Administrative Theory & Praxis* 403 403.
[35] LP Jones *Public enterprise in less developed countries* (1982) 3.
[36] OECD *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries* (2005) 20-21.
[37] A Cuervo-Cazurra, A Inkpen, A Musacchio & K. Ramaswamy "Governments as owners: State-owned multinational companies" (2014) 45(8) *Journal of International Business Studies* 919 921.
[38] A Cuervo-Cazurra, A Inkpen, A Musacchio & K. Ramaswamy "Governments as owners: State-owned multinational companies" (2014) 45(8) *Journal of International Business Studies* 919 921.

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confident and satisfied with private ownership of certain "productive assets".[39] The authors identify a number of political ideologies and strategies which might result in the creation of SOEs and these include communism, nationalism and social and strategic reasons.[40] It is submitted that a government's ideology will influence whether it will be using SOEs, regulation, taxes or other intervention measures when the need for government intervention arises. Toninelli argues along similar lines that the motives for governments' use of SOEs can be grouped into three main categories, namely "political and ideological reasons", "social motives" and "economic reasons".[41] Jones and Mason[42] are in agreement with these other authors when they state that SOEs exist or are created:

1. for ideological reasons;
2. to acquire or consolidate political or economic power;
3. due to historical heritage and inertia; and
4. as a pragmatic response to economic problems.

The authors rightly point out that SOEs are one of the many options available to governments when responding to economic crises. Other options mentioned by them include, inter alia, the provision of subsidies and various kinds of direct controls by the government.[43] This was seen during the 2008 financial crisis when governments had to respond to an imminent danger of collapse of the international financial system. A complete discussion of the 2008 financial crisis is beyond the scope of this study. It does however require mention as it is the one major recent event that required government intervention in developed countries including those that are generally suspicious of government intervention in markets. Kaufman states that irresponsible mortgage practices by financial institutions were a significant cause of

[39] A Cuervo-Cazurra, A Inkpen, A Musacchio & K. Ramaswamy "Governments as owners: State-owned multinational companies" (2014) 45(8) *Journal of International Business Studies* 919 921.
[40] A Cuervo-Cazurra, A Inkpen, A Musacchio & K. Ramaswamy "Governments as owners: State-owned multinational companies" (2014) 45(8) *Journal of International Business Studies* 919 921.
[41] P Toninelli "From private to public to private again: a long-term perspective on nationalization" (2008) 189 *Análise Social* 675 678-679.
[42] LP Jones & ES Mason "Role of economic factors in determining the size and structure of the public-enterprise sector in less-developed countries with mixed economies" in LP Jones (ed) *Public Enterprise in Less Developed Countries* (2009) 17 17.
[43] LP Jones & ES Mason "Role of economic factors in determining the size and structure of the public-enterprise sector in less-developed countries with mixed economies" in LP Jones (ed) *Public Enterprise in Less Developed Countries* (2009) 17 19.

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the 2008 crisis and that the management of leading financial institutions failed to implement proper structure which could assist such institutions dealing with risk.[44] Consequently the crisis struck at the "heart of the global economy rather than damaging its limbs."[45] Governments all over the world had to save big banks and corporations from financial failure. Some responded by nationalising private enterprises.

In 2015 the OECD also did "stocktaking of government rationales for enterprise ownership".[46] Twenty four countries[47] took part in the OECD process. The OECD concluded that the overall objectives for state ownership of enterprises in those countries which took part in the process are (i) to support national economic and strategic interests; (ii) to ensure continued national ownership of enterprises; (iii) to supply specific public goods or services when the state deems that the market cannot supply the same goods or services; (iv) to perform business operations in a "natural" monopoly situation; and (v) to create a state-owned monopoly (or oligopoly) where market regulation is deemed infeasible or inefficient.

Governments either create new SOEs or they nationalise private enterprises. Nationalisation refers to the process whereby certain industries are transferred to state or public ownership. The literature shows that nationalisation in some developed countries had been used as a tool for economic development to address shocks caused by major historical event.[48] Events at the time of the establishment of the SOE or the nationalisation of a private enterprise may provide clarity on the government's reasons for making use of SOEs at that time. Prokopenko and Pavlin state that after World War II governments all over the world used SOEs as an economic developmental tool to achieve certain social goals as these enterprises

[44] H Kaufmann *The Financial Crisis: Causes and Remedies* (2008) 253.
[45] H Kaufmann *The Financial Crisis: Causes and Remedies* (2008) 253. For more reading on the 2008 global financial crisis see also J Carmassi, D Gros & S Micossi "The Global Financial Crisis: Causes and Cures" (2009) 47(5) *Journal of Common Market Studies* 977 977–996.
[46] See OECD *State-Owned Enterprise Governance: A Stocktaking of Government Rationales for Enterprise Ownership* (2015) (accessible at http://dx.doi.org/10.1787/9789264239944-en).
[47] They are Canada, Chile, the Czech Republic, Estonia, Finland, Germany, Hungary, Ireland, Israel, Italy, Japan, Lithuania, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Sweden, Switzerland, the United Kingdom, and Turkey.
[48] In the United States of America it was a key tool after the Great Depression while in Europe the devastation caused by the two World Wars saw countries using nationalisation to rebuild their economies. In Europe the governments of countries such as Britain and France were big proponents of nationalisation of key industries after World War II.

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were expected to generate employment, assist in regional development, provide social service, sell output at lower than market prices and ensure a more equal distribution of income.[49] SOEs played a central role in the industrialisation process of many countries.[50] Today SOEs are still created to assist governments with the development of strategic industries and to ensure control by the government over these industries[51] even though many countries have had some kind of experience with privatisation.[52] Many services and goods are still being provided by governments through the use of SOEs[53] which are either newly established or private enterprises that were nationalised. Toninelli[54] states that it is sometimes not clear why governments make a particular choice between nationalising private enterprises and establishing new SOEs, but whatever choice is made is influenced by a number of factors which include political, ideological and economic reasons and social motives.

In South Africa all the above reasons and South Africa's own unique circumstances[55] influenced the government to create new SOEs and retain those SOEs which it inherited from the Apartheid government. Eskom,[56] for example, which was created in the 1920s formed part of the Apartheid government's economic assets and today it forms part of the African National Congress (ANC) government's economic assets. Even though the SOE has been plagued by problems in recent times, from financial and governance problems to operational problems and allegations of severe corruption and fraud within the SOE,[57] it would be ambitious to think that the government will ever consider private equity in the SOE. Beside its historical heritage, Eskom remains one of South Africa's most important SOEs because of it is

[49] J Prokopenko & I Pavlin *Entrepreneurship Development in Public Enterprises* (1991) 8. See also WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 323.
[50] J Prokopenko & I Pavlin *Entrepreneurship Development in Public Enterprises* (1991) 8.
[51] R Vernon & Y Aharoni *State-owned enterprises in the Western economies* (1981) 9.
[52] See the comprehensive discussion on privatisation in the selected European countries below in this chapter.
[53] C Del Bo & M Florio "Public enterprises, planning and policy adoption: three welfare propositions" (2012) 15(4) *Journal of Economic Policy Reform* 263 263.
[54] PA Toninelli "The Rise and Fall of Public Enterprise" in PA Toninelli (ed) *The Rise and Fall of State-owned Enterprises in the Western World* (2000) 3 5-7.
[55] These circumstances are discussed in more details in chapter 5 and para 3 of this chapter.
[56] See the discussion on Eskom in para 3.3.2 of this chapter.
[57] See the discussion on "State capture" below in this paragraph on how Eskom has also become part of the fraud and corruption network during the Zuma administration.

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"developmental role".[58] Eskom provides jobs to thousands of South Africans, it develops crucial infrastructure, it is used for black economic empowerment purposes and it ensures that socially immobilised South Africans have access to affordable electricity. All this could be impacted if the government ever has to let go of its 100 percent shareholding in Eskom.

In conclusion, from all those reasons mentioned above, one aspect is clear and that is that SOEs are created or retained because of the particular circumstances present within a country. Such circumstances will explain why a country has many, few or no SOEs that participate in its economy. Hence those countries which have reached substantial economic development since World War II, especially Western countries, seem to have less SOEs operating as part of their economies than less economically developed countries such as China, Brazil or South Africa.

1 3 The Origin of SOEs

Megginson and Netter state that the "Great Depression, World War II and the final breakup of colonial empires" were some of the most significant reasons for governments to become more involved in the economy.[59] Western European countries after World War II unanimously accepted that the state should be involved in "strategic manufacturing industries", such as telecommunications, gas and electricity utilities, transportation and postal services.[60]

However, SOEs already existed long before these historical events. It is stated that they can already be found in the Roman Empire and even receive mention in the Old Testament.[61] Clark is of the opinion that SOEs may have existed as long as states themselves and in this regard refers, inter alia, to the Roman imperial plantations as

[58] See section 6(5) (b) of the Eskom Conversion Act No.13 of 2001 which refers to the role.
[59] WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 323. See also R Vernon & Y Aharoni *State- Owned Enterprises in the Western Economies* (1981) 8-9.
[60] WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 323.
[61] R Vernon & Y Aharoni *State-owned enterprises in the Western economies* (1981) 8.

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an example.[62] It is noted that state intervention in the economy can be divided into three phases.[63] According to Toninelli[64] the first phase started during the Renaissance and lasted until the end of the nineteenth century, the second phase commenced during the first forty years of the twentieth century and the third phase followed Wold War II and the nationalisation drive that lasted until the 1970s,[65] with countries like France even seeing huge nationalisations in the 1980s.[66] In some countries SOEs were operating in every sector of the economy, in others SOEs were only active in certain essential sectors,[67] while some others still focused on state regulation of certain sectors of their economies instead of actively intervening through the use of SOEs. In order to understand the attitude of different countries towards SOEs this chapter will discuss the origin and development of SOEs within the economies of those developed countries selected for this study and the origin and development of SOEs within South Africa.

2 SOEs within developed economies: selected EU member states

> Europe has a history of state ownership with a major expansion of state ownership of industry occurring in the inter-war years and more especially after 1945. Until the 1980s, state intervention was generally accepted in Europe…[68]

[62] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 2. See also R Vernon "The International Aspects of State-Owned Enterprises" (1979) 10(3) *Journal of International Business Studies* 7 7.
[63] PA Toninelli "The Rise and Fall of Public Enterprise" in PA Toninelli (ed) *The Rise and Fall of State-owned Enterprises in the Western World* (2000) 3 10.
[64] PA Toninelli "The Rise and Fall of Public Enterprise" in PA Toninelli (ed) *The Rise and Fall of State-owned Enterprises in the Western World* (2000) 3 10.
[65] PA Toninelli "The Rise and Fall of Public Enterprise" in PA Toninelli (ed) *The Rise and Fall of State-owned Enterprises in the Western World* (2000) 3 10.
[66] See para 2 3 of this chapter for the discussion on nationalisation in France.
[67] R Millward "Public Enterprise in the Modern Western World: A Historical Analysis" (2011) 82(4) *Annals of Public and Cooperative Economics* 375 377.
[68] D Parker "Privatisation in the European Union" in D Parker & D Saal (eds) *International Handbook on Privatisation* (2003) 105 105.

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> "Following the cessation of hostilities after World War II, several European countries undertook the nationalisation of movable and immovable, tangible and intangible property belonging to their nationals and foreigners alike."[69]

The above two statements are clear indications that state ownership of different industries could be found in all European economies after World War Two. SOEs were part of the economies of these countries like they are today in less developed countries. This part will discuss the rise and fall of SOEs as an important tool for government intervention in selective European jurisdictions.

2 1 Britain

2 1 1 The heydays of nationalisation post-World War II

As with other European countries World War II also had a major impact on Britain's economy. Britain, like the rest of Europe, continued to suffer economic problems long after the final unconditional surrender by the German Forces took place on 7 May 1945.[70] The period between 1945 and 1951 has been coined the "Age of Austerity".[71] During this time SOEs started playing an important role in the British economy. The Labour leader Clement Attlee became the Prime Minister following a landslide victory over Winston Churchill's Conservative Party.[72] It was during this time that nationalisation became a prominent part of the Labour government's policy.[73] O'Hara argues that the public sector employment raised and that the output of the nationalised industries amounted to a fifth of the economy.[74] The Bank of

[69] NR Doman "Compensation for Nationalised Property in Post-War Europe" (1950) 3(3) *International Law Quarterly* 323 323.
[70] B Price *Winston Churchill: War Leader* (2009) 137.
[71] RA Dargie *History of Britain: The Key Events That Have Shaped Britain from Neolithic Times To The 21st Century* (2007) 190.
[72] RA Dargie *History of Britain: The Key Events That Have Shaped Britain from Neolithic Times To The 21st Century* (2007) 190.
[73] See C Ellis "Letting it Slip: The Labour Party and the 'Mystical Halo' of Nationalization, 1951–1964" (2012) 26(1) *Contemporary British History* 47 48 where it is indicated that nationalisation and "common ownership" was already part of the Labour Party's 1918 Constitution.
[74] G O'Hara "What the electorate can be expected to swallow': Nationalisation, transnationalism and the shifting boundaries of the state in post-war Britain" (2009) 51(4) *Business History* 501 504. O'Hara provides figures such as a rise in public sector employment from 2 million before the war to 7 million after it, and an

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England, industries such as iron and steel, and railways became government's assets.[75]

The Bank of England Bill was one of the first pieces of legislation to kick start the Labour Party's nationalisation programme. At a meeting of the Cabinet on 13 September 1945 a memorandum served before Cabinet which suggested government ownership of the Bank of England.[76] The Cabinet expressed its approval to have the Bank of England under government ownership and this culminated in the enactment of the Bank of England Act 1946. The purpose of the Act was to "bring the capital stock of the Bank of England into public ownership and bring the Bank under public control."[77]

The next sector to follow was the coal and mining industry. The Bill for the Nationalisation of the Coal and Mining Industry served before the Cabinet in December 1945.[78] Ultimately the coal and mining industry was nationalised by the Coal Industry Nationalization Act of 1946. Its purpose was to "establish public ownership and control of the coal-mining industry and certain allied activities."[79] The nationalisation of other industries including civil aviation, cable and wireless, transport, electricity and gas and iron and steel followed.[80]

The Labour Party's nationalisation programme came to a halt when it lost the national elections in 1951. Winston Churchill, who was the Prime Minister during the war, returned to Office as Prime Minister.[81] It was only in 1964 that another Labour Party leader became the Prime Minister again, but subsequent Conservative Prime

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increase from 10% to 30% of the workforce being employed by the public sector. He also mentioned that the nationalised industries' output was £980m in 1950, which amounted to a fifth of the entire British economy.

[75] RA Dargie *History of Britain: The Key Events That Have Shaped Britain from Neolithic Times To The 21st Century* (2007) 190.

[76] See Cabinet Meeting 45, 31st Conclusions (accessible at http://filestore.nationalarchives.gov.uk/pdfs/small/cab-128-1-cm-45-31-14.pdf) (accessed on 6 January 2015).

[77] See the Preamble of the Bank of England Act 1946.

[78] See Cabinet Meeting C.P. (45) 329 (http://www.nationalarchives.gov.uk/cabinetpapers/themes/post-war-nationalisation.htm#Coal) (accessed on 6 January 2015).

[79] See the Preamble of the Coal Industry Nationalisation Act of 1946.

[80] See_http://www.nationalarchives.gov.uk/cabinetpapers/themes/post-war-nationalisation.htm (accessed on 6 January 2015).

[81] B Price *Winston Churchill: War Leader* (2009) 143.

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Ministers continued with the nationalised industries.[82] Dramatic changes to the state's role in the economy were only made when Margaret Thatcher became the Prime Minister. Millward states that it was not only the Conservative Party which was opposing nationalisation but that it came from other spheres as well, such as academia.[83] Nationalisation in Britain was soon to be considered a "historical episode".[84]

2 1 2 Divestiture of state assets: Margaret Thatcher's legacy

In 1979 Margaret Thatcher became the British Prime Minister. One of her biggest legacies is the privatisation of many of Britain's state assets.[85] Thatcher showed her disdain for state-ownership when she said:

> "The state should not be in business. State-ownership effectively removes- or at least radically reduces- the threat of bankruptcy which is a discipline on privately owned firms. Investment in state-owned industries is regarded as just another call on the Exchequer, competing for money with schools and roads. Targets can be set; warnings can be given; performance monitored, new chairmen appointed. These things help. But state-owned business can never function as a proper business."[86]

She continued that:

> "the evidence of the lamentable performance of government in running any business- or indeed administering service-is so overwhelming that the onus should

[82] JA Tomlinson "Failed Experiment'? Public Ownership and the Narratives of Post-War Britain" (2008) 73(2) *Labour History Review* 228 228. See also J Burton "Privatisation: The Thatcher Case" (1987) 8 *Managerial and Decision Economics* 21 23; and H Abdromeit "Privatisation in Great Britain" (1986) 57(2) *Annals of Public and Co-operative Economy* 153 154.
[83] R Millward "State Enterprise in Britain in the Twentieth Century" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprise in the Western World*(2000) 157 175.
[84] JA Tomlinson "'Failed Experiment'? Public Ownership and the Narratives of Post-War Britain" (2008) 73(2) *Labour History Review* 228 229.
[85] D Parker *Lessons from Privatisation* (2004) 2.
[86] M Thatcher *The Downing Street Years* (1993) 677.

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> always be on the statists to demonstrate why government should perform a particular function rather than why the private sector should not."[87]

Through the above statements Thatcher made it clear that she had no desire to continue with the status quo, namely the continued operation of SOEs in crucial industries. And so Thatcher's privatisation of British SOEs started. Megginson and Netter argue that although it was not Thatcher that introduced privatisation to the world,[88] her privatisation programme is "historically the most important". It was not always easy for the Thatcher government to ensure smooth transition of an industry from state ownership to private ownership. Sometimes there was resistance from unions, as the example of the privatisation of the British telecommunication industry showed, when a "Campaign against Privatisation" was started. When the British Telecommunications Act 1981 transferred the operation of the telecommunications system within the United Kingdom to a public corporation, British Telecom (BT), and also empowered the Secretary of State to license the operation of private telecommunications systems which could compete with BT, there was strong opposition. In February 1982 when the Secretary of State granted a licence to a company, Mercury Communications Ltd, to compete with BT, the union to which many of BT's employees belonged, opposed both the licensing of competing private systems such as that operated by Mercury Communications Ltd and a proposal by the government, which was contained in a Bill which was before Parliament, to convert BT into a public company and to sell shares in the company to the public.[89]

Megginson and Netter commented that the goals of Thatcher's privatisation programme were to:

> "(1) raise revenue for the state;

[87] M Thatcher *The Downing Street Years* (1993) 679.
[88] They are of the opinion that it was the Adenauer government in Germany that started with "denationalisation" after World War II when they decided to sell a majority stake in Volkswagen and four years later the "denationalisation" of the Vereinigte Elektrizitäts und Bergwerks Aktiengesellschaft (VEBA). See WL .Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 324.
[89] *Mercury Communications Ltd v Scott-Garner* [1984] 1 All ER 179.

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(2) promote economic efficiency;

(3) reduce government interference in the economy;

(4) provide wider share ownership;

(5) provide the opportunity to introduced competition; and

(6) subject SOEs to market discipline." [90]

Thatcher stated that the Conservative Party's manifesto in 1979 did not mention privatisation as one of their key policies.[91] The privatisation of only a few SOEs was mentioned in the manifesto: those of British Aerospace, shipbuilding enterprises and the National Freight Consortium. Shares in these concerns were sold to the public and employees were given the opportunity to acquire shares.[92] During Thatcher's first term in office, privatisation of state assets took place on a small scale.[93] Thatcher provided various reasons for this, which inter alia included, "low market confidence" and "large nationalised industries losses."[94] An intensified privatisation programme took off during Thatcher's second term in office[95] when she felt that the "economic conditions improved and the prospects for privatisation improved with them."[96] In its 1983 manifesto, the Conservative Party listed a number of SOEs which would eventually be privatised during Thatcher's second term in office. These included British Airways, British Telecom, Rolls-Royce, British Steel, British Leyland and Britain's airports.[97]

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[90] WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 324.

[91] M Thatcher *The Downing Street Years* (1993) 677.

[92] See K Bradley & A Nejad *Managing owners: The National Freight Consortium in Perspective* (1989) 2 See also M Thatcher *The Downing Street Years* (1993) 678; and R Millward "State Enterprise in Britain in the Twentieth Century" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprise in the Western World* (2000) 157 177.

[93] Enterprises privatised during the first Thatcher administration included Cable and Wireless, Associated British Ports, Britoil, British Rail Hotels and Amersham International. See M Thatcher *The Downing Street Years* (1993) 678. See also R Millward "State Enterprise in Britain in the Twentieth Century" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprise in the Western World* (2000) 157 177.

[94] M Thatcher *The Downing Street Years* (1993) 678.

[95] J Burton "Privatization: the Thatcher Case" (1987) 8(1) *Managerial and Decision Economics* 21 24. See also M Thatcher *The Downing Street Years* 1993) 678; and R Millward "State Enterprise in Britain in the Twentieth Century" in PA Toninelli *The Rise and Fall of State-Owned Enterprise in the Western World* (2000) 157 177.

[96] M Thatcher *The Downing Street Years* (1993) 678.

[97] M Thatcher *The Downing Street Years* (1993) 678.

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The privatisation programme quickly turned towards the public utilities such as telecommunications, gas, electricity, railways and water. When privatisation reached the water supply industry, emotions were running high. Thatcher states that it was said that "she's even privatising the rain which falls from the heavens" to which she responded:

> "the rain may come from the Almighty but he did not send the pipes, plumbing and engineering to go with it."[98]

Certain measures to liberalize markets were taken to ensure that a state-owned monopoly did not merely turn out to be a private-owned monopoly after privatisation.[99] If this were the case, competition among British enterprises, which was one of Thatcher's main priorities, would not have been achieved. Dobek argues that "enhanced economic efficiency of the targeted enterprises" through competition between British enterprises, was probably the most important aim of Thatcher's privatisation programme.[100] Therefore public utilities were either restructured or broken up into various businesses before privatisation, to eliminate any monopoly. Where such restructuring or break up was difficult or not possible at the time of privatisation, as was the case with British Gas, the whole utility was privatised but some regulation was put in place to ensure that market power would not be abused. When it was time for Thatcher to leave office, she said the following of the privatisation which took place during her time in office:

> "There was still much I would have liked to do. But Britain under my premiership was the first county to reverse the onward march of socialism. By the time I left office, the state-owned sector of industry had been reduced by some 60 per cent. Around

[98] M Thatcher *The Downing Street Years* (1993) 682.
[99] Thatcher stated that in the case of British Telecom, for example, it was split from the Post Office and its monopoly on the sales of telephones was removed. A competitor, Mercury, was licenced. For more on the licencing of Mercury and the Post Office Engineering Union's opposition to the privatisation of the British telecommunications sector see *Mercury Communications Ltd v Scott-Garner* [1984] 1 All ER 179. Thatcher also provides a detailed description on measures that were taken to ensure competition within the other sectors within which the public utilities operated, such as British Gas, the water industry and the electricity supply industry. See M Thatcher *The Downing Street Years* (1993) 680.
[100] MM Dobek "Privatisation as a Political Priority: The British Experience" (1993) 41(1) *Political Studies* 24 25.

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> one in four of the population owned shares. Over six hundred thousand jobs had been passed from the public to the private sector. It constituted the greatest shift of ownership and power away from the state to individuals and their families in any country outside the former communist bloc. Indeed Britain set a worldwide trend in privatization… And privatisation is not only one of Britain's most successful exports: it has re-established our reputation as a nation of innovators and entrepreneurs. Not a bad record for something we were constantly told was 'just not on'."[101]

Thatcher seemed to have been satisfied with and even proud of the privatisation of state assets during her administrations. Privatisation however did not stop when Thatcher left office. It was continued by her successors.

2 1 3 SOEs after Thatcher and in present-day Britain

John Major came to power in 1990. He continued the privatisation of state assets which Margaret Thatcher started. An example of privatisation which took place during Major's time as Prime Minister includes the railways.[102] When the Labour Party returned to power in 1997, it did not pursue its aims of nationalisation.[103] Even its threat to renationalise those industries which the Conservative governments privatised was abandoned.[104] It is noted that the Labour Party even completed the privatisation process in those instances where the planned privatisation of an industry under the Conservative governments had initially been postponed.[105] The Labour government though did not use the term privatisation but preferred to refer to the process as "public private partnerships"[106] or "public ownership".[107]

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[101] M Thatcher *The Downing Street Years* (1993) 687.

[102] The Railways Act 1993 was enacted to privatise the railway network. For more on the privatisation of the railways see *Re Railtrack plc (in railway administration) Winsor v Bloom* [2002] 4 All ER 435 para 13.

[103] D Parker "Privatisation and the Labour Governments 1997-2010" (2013) 84(4) *Annals of Public and Cooperative Economics* 343 345.

[104] D Parker "Privatisation and the Labour Governments 1997-2010" (2013) 84(4) *Annals of Public and Cooperative Economics* 343 345.

[105] D Parker "Privatisation and the Labour Governments 1997-2010" (2013) 84(4) *Annals of Public and Cooperative Economics* 343 345.

[106] D Parker "Privatisation and the Labour Governments 1997-2010" (2013) 84(4) *Annals of Public and Cooperative Economics* 343 345. See also JL Navarro-Espigaresa & JA Martın-Segura "Public–private partnership and regional productivity in the UK" (2011) 31(4) *Service Industries Journal* 559 559 where the authors provide the OECD's definition of a public private partnership: "The OECD defines a public–private partnership (PPP) as an agreement between the government and one or more private partners (which may

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Today the British government makes use of another type of public-private partnership besides privatisation. It was introduced in Britain in 1992 by the Conservative governments and is called the "private finance initiative".[108] It is said that the United Kingdom is at the forefront when it comes to the development of new ways of getting the private sector more involved in public service delivery and the private finance initiative (PFI) is one such developments.[109] PFI has been described as follows:

> "The Private Finance Initiative is a form of public-private partnership that combines procurement, where the public sector purchases capital items from the private sector, with an extension of contracting-out, where public services are contracted from the private sector. It differs from privatisation in that the public sector retains a substantial role as the main purchaser of services or as the enabler of the project. It also differs from contracting out since the private sector provides the capital asset as well as the services. A Private Finance Initiative contract is intended to provide a continuing commercial incentive for synergy, flexibility and efficiency right through from initial design, build and operation."[110]

The PFI has already been heavily criticized for bringing about an increase in government debt which the taxpayer has to cover.[111] Criticism of the PFI has been

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include the operators and the financers) according to which the private partners deliver the service in such a manner that the service delivery objectives of the government are aligned with the profit objectives of the private partners and where the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners."

[107] M Thatcher *The Downing Street Years* (1993) 676.

[108] D Parker "Privatisation and the Labour Governments 1997-2010" (2013) 84(4) *Annals of Public and Cooperative Economics* 343 346. See also N Wang "Private finance initiative as a new way to manage public facilities" (2014) 32(11-12) *Facilities* 584 584 for a description of this concept. It is described as "an innovative way for public facilities to be financed and operated. In PFI procurement, the public sector defines the requirements to meet public needs and ensures delivery of the outputs through the contract, while the private sector is harnessed to deliver a perceived better quality of public services. PFI procurement allows the private sector to finance the capital costs of the projects, which are paid back by the public sector, …., in the form of PFI grant over a period of time, namely, the concession period."

[109] D Corner "The United Kingdom Private Finance Initiative: The Challenge of Allocating Risk" (2006) 5(3) *OECD Journal on Budgeting* 37 37.

[110] D Corner "The United Kingdom Private Finance Initiative: The Challenge of Allocating Risk" (2006) 5(3) *OECD Journal on Budgeting* 37 40.

[111] See Private Finance Initiative: where did all go wrong?

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given further momentum by the collapse of Carillion, the UK's second largest construction business.[112] Its future use will be judged by its current success rate and how it improves, if at all, public service delivery.

After Margaret Thatcher started her privatisation programme, many followed suit without hesitation.[113] Her privatisation programme was the cause for "a wave of imitative privatisation policies around the world."[114] Whether the PFI will have the same impact remains to be seen.[115]

2 2 Germany

2 2 1 SOEs in the Federal Republic of Germany post-World War II: 1949 onwards until reunification of the Federal Republic of Germany (West Germany) and the German Democratic Republic (East Germany)

SOEs could be found in Germany during the German empire, the Weimar Republic, the Third Reich (also referred to as "Nazi Germany") and in the Federal Republic of Germany (also referred to as West Germany). In 1945, after World War II Germany was divided into four zones. Each zone was governed by one of the major Allied Forces.[116] In 1949 the zones governed by France, Britain and the United States together became the Federal Republic of Germany (West Germany) and the zone governed by Russia became East Germany (the German Democratic Republic). Most enterprises in East Germany were nationalised and it had a "centrally planned economy".[117] A study of SOEs in East Germany is beyond the scope of this study.[118]

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http://www.telegraph.co.uk/news/health/news/8779598/Private-Finance-Initiative-where-did-all-go-wrong.html - (accessed on 1 March 2015).

[112] I Khadaroo & E Salifu "PFI has been a failure – and Carillion is the tip of the iceberg" the Conversation (24 January 2018) (accessible at https://theconversation.com/pfi-has-been-a-failure-and-carillion-is-the-tip-of-the-iceberg-90487).

[113] Thatcher states that Britain set a worldwide trend in privatization in countries as "different as Czechoslovakia and New Zealand". See M Thatcher *The Downing Street Years* (1993) 687.

[114] J Burton "Privatization: the Thatcher Case" (1987) 8(1) *Managerial and Decision Economics* 21 22.

[115] Representatives of the Gauteng Province in South Africa have already made a fact-finding trip to the UK to learn more about the PFI. See 'Early participation critical': Valuable lessons learned during fact-finding trip to Britain Finweek 29 November 2007 70.

[116] Allied Forces in this context refers to the United States of America, France, Great Britain and Russia.

[117] A Marketline Case Study *Germany, a country united, an economy divided* (2004) 2. See also U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-*

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West Germany, on the other hand, operated a free market economy based on supply and demand and it inherited some SOEs from the Third Reich.[119]

Article 15 of the Basic Law of Germany,[120] which deals with "socialisation", makes provision for nationalisation when required. The Article states that:

> "Land, natural resources and means of production may for the purpose of socialisation be transferred to public ownership or other forms of public enterprise by a law that determines the nature and extent of compensation."

Wengenroth states that the history of SOEs in present-day Germany should be considered on three levels, namely national, state and municipal as Germany is a decentralised federal state. Consequently state ownership existed on all three levels.[121] The Federal Republic of Germany consists of sixteen states (Bundesländer).This study will focus on national SOEs but where the context of the discussion requires it, reference will be made to those SOEs which exist on state and municipal level.

At the Potsdam Conference (July and August of 1945), which was a meeting between the leaders of the United States, United Kingdom and the then-USSR on post-war Germany, many matters regarding Germany were decided. These matters, inter alia, included "political principles" and "economic principles".[122] An Allied Control Council created policy for the whole of Germany.[123] This included the

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Owned Enterprises in the Western World (2000) 103 118; and M Weiss & M Schmidt *Labour Law and Industrial Relations in Germany*(2008) 21.

[118] For further reading on SOEs in East Germany see S Supranowitz "The Law of the State-Owned Enterprise in a Socialist State" (1961) 26(4) *Law and Contemporary Problems* 794 794-801.

[119] U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 118.

[120] Basic Law for the Federal Republic of Germany (the revised version) published in the Federal Law Gazette Part III, classification number 100-1, as last amended by the Act of 11 July 2012 (Federal Law Gazette I page 1478).

[121] [121] U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 103. See also P Eichhorn "Public Enterprises in Germany: Definition, Ownership, Objectives and Control" (1991) 62(1) *Annals of Public and Cooperative Economics* 63 63.

[122] http://avalon.law.yale.edu/20th_century/decade17.asp (visited on 30 January 2015).See also H-J Braun *The German Economy in the Twentieth Century: The German Reich and the Federal Republic* (1990) 148.

[123] SJ Wiesen *West German Industry and the Challenge of the Nazi Past, 1945-1955* (2004) 41.

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economic policy to rebuild the country after the war, which included the "desire to keep industry from expanding to threatening levels".[124] One of the economic principles of the Potsdam Conference determined that Germany was to be treated as a single economic unit during the occupation and common policies were made in regard to certain industries, which inter alia included mining, industrial production and allocation as well as transportations and communications.[125]

SOEs of the former state of Prussia,[126] SOEs which had their origins in the Weimar Republic and those established during the Nazi period all formed part of the German state after World War II.[127] Among these SOEs were:

(i) Salzgitter AG, which was formerly called the Hermann Goering Works and was established during the Nazi period for the production of steel;

(ii) the Vereinigte Industrieunternehmungen AG (VIAG), which was a state holding company created for firms established during the empire in a number of industries including the aluminium industry and electricity supply;[128]

(iii) the former Prussian Vereinigte Elektrizitäts- und Bergwerks-Aktiengesellschaft (VEBA), which had a stronghold in coal mining;

(iv) Volkswagenwerke, which was established by Hitler's government, it manufactured cars and during the war its main focus was the manufacturing of war armaments such as tanks, aircraft engines and missiles; and

(v) the Saarbergwerke, which also belonged to Prussia during its existence and was conducting coal mining.[129]

Besides those inherited SOEs, a few new SOEs were created such as Lufthansa in 1954 and some banks which were important for reconstruction of the economy.[130]

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[124] SJ Wiesen *West German Industry and the Challenge of the Nazi Past, 1945-1955* (2004) 41.
[125] http://avalon.law.yale.edu/20th_century/decade17.asp (visited on 30 January 2015).
[126] Prussia was one of the German states which existed until World War II. The Allied Control Council, which was the body in control of policy making for the whole of occupied Germany, signed a Law in 1947, which determined the cessation of the state of Prussia. See GA Graig "The End of Prussia" (1980) 124(2) *Proceedings of the American Philosophical Society* 97 97.
[127] U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 119.
[128] *Civil Affairs Handbook: Germany,* United States Army Forces (1944) 186.
[129] U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 113-119.
[130] U Wengenroth "State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 119.

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The inherited SOEs were mostly kept to limit unemployment.[131] No economic policy was put in place which would pave the way for bigger state intervention in the economy and the expansion of state assets as in Britain and France. Germany's nationalisations were therefore dwarfed by those of France and Britain.[132] The fact that Germany rejected big scale nationalisations of industries, unlike Britain and France, is certainly contrary to what could have been expected considering the economic devastation caused by the war. It is therefore in a sense surprising that state intervention in the economy was so limited especially as it was considered normal for European governments to step in when their economies needed to be reconstructed or rebuilt after a destructive event such as the war and also since state economic intervention took place all over Europe after the war.

The decision by the government of the Federal Republic of Germany to concentrate more on "entrepreneurial activities" to rebuild, reconstruct and strengthen its war-torn economy instead of using nationalisation is certainly an interesting matter. What made the German leaders at the time decide against intensified nationalisations to rebuild their war-torn economy? Germany's early attitude towards state intervention could have played a role in her "economic miracle".[133] Stolper and Roskamp observe that Germany at an early stage decided to integrate with the rest of the western world and to create a productive and internationally competitive economy.[134] Even though most European countries and countries around the world were nationalising industries during this time, it is stated that public enterprises were seen as "strange bodies" as they did not converge with the economic policies of Konrad Adenauer's first conservative government in 1949.[135]

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[131] U Wengenroth "State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 119.

[132] See for example NR Doman "Compensation for Nationalised Property in Post-War Europe" (1950) 3(3) *International Law Quarterly* 323 332 where he said that "The other countries of the Western European continent have nationalised on a much smaller scale, if at all."

[133] See K Duwell "Germany 1945-1950: Problems of the 'Economic Miracle'" (1983) 33(9) *History Today* 4 4-9.

[134] WF Stolper & K W Roskamp "Planning a Free Economy: Germany 1945-1960" (1979) 135(3) *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics* 374 377.

[135] G Himmelmann "Public Enterprise in the Federal Republic of Germany" (1985) 56(3) *Annals of Public and Cooperative Economy* 365 365.

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Could the decision of no or limited state intervention in the post-war economy be attributed to the influence of Germany's first post-war elected Chancellor, Konrad Adenauer? He was a law and economics graduate and one of the founders of the Christian Democratic Union political party. Adenauer was described as a "master tactician, constantly employing [threats to Germany] and offering bold solutions in order to reinforce his indispensability."[136] When Adenauer was elected as Chancellor it was expected that he would continue with free enterprise in Germany[137] after the expansion of state-ownership[138] during the Third Reich in industries such as aviation and iron and steel.[139] During an address at Chatham House[140] in London on 6 December 1951 Konrad Adenauer said the following regarding the destruction of the German economy by the war:

> "We can bear the financial burden imposed by our social tasks only if the capacity of our economy is fully utilized. We have decided in favour of a social competitive and free economy in Germany because we believe that we can thus attain speedy and favourable results. Only an effective increase of our national product can enable the German people to improve their standard of living."

Adenauer had no appetite for high level of state intervention in the economy. Instead of following the route of nationalisation which Britain and France followed to address economic and social issues, Adenauer chose a free market economy which allowed for a limited level of state intervention. His economic policy, the "Soziale Marktwirtschaft" or Social Market Economy, "combined free enterprise with a social programme"[141] and required the state to provide a "stable legal and social order".[142]

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[136] J Dülffer "No more Potsdam!" Konrad Adenauer's Nightmare and the Basis of his International Orientation" (2007) 25(2) *German Politics and Society* 19 20.
[137] F Miller "World News Makers" (1949) 112(4) *World Affairs* 121 121.
[138] Some industries though such as insurance, coal and energy-supply remained in the hands of private owners as Hitler was not in favour of their nationalisation. See RJ Overy *War and Economy in the Third Reich* (1995) 16.
[139] RJ Overy *War and Economy in the Third Reich* (1995) 16.
[140] Chatham House, the Royal Institute of International Affairs, is an independent policy institute based in London, whose mission is to help build a sustainably secure, prosperous and just world. The institute was founded in 1920 and engages governments, the private sector, civil society and its members in open debate and confidential discussion on the most significant developments in international affairs. - See more at: http://www.chathamhouse.org/about (visited on 3 February 2015).
[141] CL Glossner & D Gregosz *The Formation and Implementation of the Social Market Economy by Alfred Mueller and Ludwig Erhard: Incipiency and Actuality* (2011) 12. For further reading on the Social Market

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Adenauer's economic policy "emphasised the state's responsibility actively to improve the market condition and simultaneously to pursue a social balance."[143] The "Soziale Marktwirtschaft" is attributed to Ludwig Erhard, who was Adenauer's Vice-Chancellor and the German Federal Republic's first Minister for Economic Affairs.[144] Erhard believed that "Prosperity for all" and "Prosperity through Competition" are inseparable. He was a staunch proponent of a free market economy with a social character which would not be "hindered or eliminated through artificial or legal manipulations."[145] As a result of the "Soziale Marktwirtschaft", nationalisation of industries in Germany was moderate[146] in comparison, for example, with the nationalisation programme which commenced in Britain under Atlee after the war. The emphasis was instead on private enterprises and everything associated with a market economy,[147] although laws were enacted which protected not only private enterprises but also the social aspect of the economy.[148]

Margaret Thatcher, the British Prime Minister, is not the "big inventor" of privatisation as it is known today, even though her government might have had historically the most ambitious and influential privatisation programme.[149] It was Konrad Adenauer who, twenty years before Thatcher's privatisation programme, started the first "large-scale, ideologically motivated denationalization program".[150] In 1961 the Adenauer government sold a majority share in Volkswagen through a public share offering and

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Economy see JC Van Hook *Rebuilding Germany: The Creation of the Social Market Economy, 1945-1957* (2004).

[142] C Allen "Between Social Market Economy and Corporatist Crisis Management: The West German Economy at Forty" (1989) 16 *German Politics & Society* 41 48.

[143] CL Glossner & D Gregosz *The Formation and Implementation of the Social Market Economy by Alfred Mueller and Ludwig Erhard: Incipiency and Actuality* (2011) 12.

[144] G Thiemeyer "The "Social Market Economy" and its Impact on German European Policy in the Adenauer Era, 1949-1963" (1983) 25(2) *German Politics & Society* 68 68-85.

[145] L Erhard *Prosperity through Competition: The Economics of the German Miracle* (1958) 2.

[146] E Schroter "Reforming the Machinery of Government: The Case of the German Federal Bureaucracy" in R Koch & J Dixon (ed) *Public Governance and Leadership: Political and Managerial Problems in Making Public Governance Changes the Driver for Re-Constituting Leadership* (2007) 251 254.

[147] WF Stolper & KW Roskamp "Planning a Free Economy: Germany 1945-1960" (1979) 135(3) *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics* 374 379.

[148] L Erhard *Prosperity through Competition: The Economics of the German Miracle* (1958) 2.

[149] WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 323.

[150] WL Megginson, RC Nash & M van Randenborgh "The Financial and Operating Performance of New Privatized Firms: An Empirical Analysis in TL Anderson & PJ Hill *The Privatization Process: A Worldwide Perspective* (1996) 115 118.

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four years after that first divestiture it sold a major stake in VEBA.[151] In regard to Volkswagen though, certain provisions within the Law on the Privatisation of Equity in the Volkswagenwerk Limited Company of 21 July 1960 (the VWLaw),[152] allowed the government to impose certain restrictions after privatisation. These measures included the following:

(i) a limitation of voting rights to "20 % of the share capital" even if a shareholder hold an excess of that amount[153] and at the general meeting of the company, no person could exercise a voting right which corresponds to more than one fifth of the share capital;[154]

(ii) the Federal Republic of Germany and the State of Lower Saxony (Niedersachsen) were allowed to appoint representatives to the supervisory board of Volkswagen if they held shares in the company regardless of the amount;[155] and

(iii) resolutions of the general meeting, which would normally in terms of the German Aktiengesetz (the German Stock Corporation Act) require a "favourable vote" of at least 75%, required in terms of the VW Act a favourable vote of 80%.[156]

Through this legislation the government maintained a certain level of control over Volkswagen. Certain provisions of the VW Law have been challenged on a number of occasions but Germany has enacted legislation to repeal those provisions of the VW Law and to align it with EU law without giving up much of the influence of Lower Saxony.[157]

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[151] WL Megginson & JM Netter "From State to Market: A survey of empirical studies on privatisation" (2001) 39(2) *Journal of Economic Literature* 321 323-234. See also B Bortolotti & D Siniscalco*The Problems of Privatization: An International Analysis* (2004) 1.

[152] Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand.

[153] Para 3(5) of the VW Law provides: "At the general meeting, no person may exercise a voting right which corresponds to more than one fifth of the share capital". See also G- J Vossestein "Volkswagen: The State of Affairs of Golden, General Company law and European Free Movement of Capital" (2008) 5(1) *European Company and Financial Law Review* 115 116.

[154] Para 3(5) of the VW Law. See also *Commission of the European Communities v Federal Republic of Germany,* Case C-112/05 ECLI: EU: C: 2007: 623 para 6.

[155] Para 4 (1) of the VW Law provides: "The Federal Republic of Germany and the Land of Lower Saxony may each appoint two members to the supervisory board on condition that they hold shares in the company."

[156] Para 4 of the VW Law. See also *Commission of the European Communities v Federal Republic of Germany* Case C-112/05 ECLI: EU: C: 2007: 623 para 7; and F Sander "Case C-112/05, European Commission v. Federal Republic of Germany: The Volkswagen Case and Art. 56 EC- A Proper Result, Yet Also a Missed Opportunity" (2008) 14(2) *Columbia Journal of European Law* 359 361.

[157] *Commission of the European Communities v Federal Republic of Germany* Case C-112/05 (2007) ECR I-08995; and *European Commission v Federal Republic of Germany* Case C-95/12 ECLI: EU: C: 2013: 676
See also F Sander "Case C-112/05, European Commission v. Federal Republic of Germany: The Volkswagen Case and Art. 56 EC- A Proper Result, Yet Also A Missed Opportunity" (2008) 14(2) *Columbia Journal of European Law* 359 359–370.

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The post-war successes of German industries could also have played a role in the government's decision to maintain limited state economic intervention. Industries, after some time, started to reach their pre-war production levels and while in 1948 only three industries surpassed their 1936 output, this number rose to thirteen in 1950 and some industries more than doubled production between 1948 and 1950.[158] The only industries that were lagging behind were coal and mining as well as iron and steel.[159] It is submitted that such statistics may have satisfied those in charge of the German economy that sufficient progress to overcome the economical destruction caused by the war could be made without intensifying nationalisation.

There was some state interference in the early 1950s when financially-sound businesses were requested to subsidise certain "bottleneck industries", which included industries such as iron and steel and coal mining which were slow to reach their pre-war production.[160] This state intervention, however, did not endure for long. The moment the "bottleneck industries" were stabilised, the intervention ended and there was a return to free enterprise.[161] The attitude towards state economic intervention which existed during the Adenauer era prevailed in Germany. Even in the late 1980s it was acknowledge that the Federal Republic of Germany did not have a "massive wave of nationalisations" but instead, it opted for "solutions rather closer to the market", when it had to assist certain industries.[162] The different federal governments of the Federal Republic of Germany that followed the Adenauer administration were never enthusiastic about nationalisation.[163] The five chancellors

[158] WF Stolper & KW Roskamp "Planning a Free Economy: Germany 1945-1960" (1979) 135(3) *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics* 374 385.
[159] WF Stolper & KW Roskamp "Planning a Free Economy: Germany 1945-1960" (1979) 135(3) *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics* 374 385.
[160] WF Stolper & K.W Roskamp "Planning a Free Economy: Germany 1945-1960" (1979) 135(3) *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics* 374 396.
[161] WF Stolper & KW Roskamp "Planning a Free Economy: Germany 1945-1960" (1979) 135(3) *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics* 374 396.
[162] M Fiedler "Investment by Public Enterprises in the Federal Republic of Germany" (1988) 59(4) *Annals of Public and Cooperative Economics* 455 457.
[163] E Schroter "Reforming the Machinery of Government: The Case of the German Federal Bureaucracy" in R Koch & J Dixon (ed) *Public Governance and Leadership: Political and Managerial Problems in Making Public Governance Changes the Driver for Re-Constituting Leadership* (2007) 251 254.

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that succeeded Adenauer,[164] all with different economic policies and political ideologies, continued to support limited state intervention in the economy.

2 2 2 SOEs in a reunited Germany: post 1990 until the present-day Federal Republic of Germany

In October 1990 the German Democratic Republic reunified with the Federal Republic of Germany to form the present-day Federal Republic of Germany. On 18 May 1990 the two countries entered into a treaty to establish a monetary, economic and social union.[165] There were of course other legislative measures in regard to the reunification but for purposes of this study reference will only be made to the treaty that dealt with economic reunification. Article I of the treaty determines that:

> "(3) The basis of the economic union shall be the social market economy as the common economic system of the two Contracting Parties. It shall be determined particularly by private ownership, competition, free pricing and, as a basic principle, complete freedom of movement of labour, capital, goods and services; this shall not preclude the legal admission of special forms of ownership providing for the participation of public authorities or other legal entities in trade and commerce as long as private legal entities are not subject to discrimination."

Importance was attached to, inter alia, a "social market economy", "private ownership" and "competition". This ultimately had an effect on SOEs in the German Democratic Republic. As already noted above, the German Democratic Republic operated a "centrally planned economy", with most enterprises being state-owned.[166] The treaty introduced a social market economy to the parts of Germany that constituted the German Democratic Republic. This served as a basis for the

[164] The five chancellors are Ludwig Erhard (1963-1966), Kurt Georg Kiesinger (1966-1969), Willy Brandt (1969-1974), Helmut Schmidt (1974-1982) and Helmut Kohl (1982-1990).
[165] G Wegen & CL Crosswhite "Federal Republic of Germany- German Democratic Republic: Treaty establishing a monetary, economic and social union" (1990) 29(5) *International Legal Materials* 1108 1108-1185.
[166] A Marketline Case Study *Germany, a country united, an economy divided* (2004) 2. See also U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 118; and M Weiss & M Schmidt *Labour Law and Industrial Relations in Germany* (2008) 21.

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economic development of the erstwhile German Democratic Republic.[167] Article 14 of the treaty dealt with the structural adjustment of enterprises and the government of the German Democratic Republic was required to ensure "swift structural adjustment of enterprises to the new market conditions" with the object of achieving competitiveness.[168] As most enterprises in the German Democratic Republic were part of the "centrally planned economy", they were subject to this arrangement.

Helmut Kohl, the first Chancellor of a reunified Germany transformed the SOEs of the former German Democratic Republic. His administration created an agency, the Treuhandanstalt (Trust Agency), to privatise SOEs in the German Democratic Republic.[169] It had to achieve privatisation over a period of five year.[170] The agency only kept those SOEs which were economically sound alive.[171] As a consequence of this privatisation programme many former employees of these SOEs became redundant.[172] However, this did not seem to have any impact on the decision to privatise, as it was one of the economic principles which were included in the treaty for an economic union.

Since the first privatisations in the late 1950s when SOEs in the Federal Republic of Germany were sold to the public through people shares, a free market economy has been preferred by the different federal administration.[173] According to an OECD report[174], compiled in 2011, on the size and composition of SOEs in OECD countries, the federal government of Germany had no majority-owned listed entities;

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[167] See the Preamble of the Treaty.
See also G Wegen & CL Crosswhite "Federal Republic of Germany- German Democratic Republic: Treaty establishing a monetary, economic and social union" (1990) 29(5) *International Legal Materials* 1108 1120.
[168] Article 14 of the Treaty. See G Wegen & CL Crosswhite "Federal Republic of Germany- German Democratic Republic: Treaty establishing a monetary, economic and social union" (1990) 29(5) *International Legal Materials* 1108 1129.
[169] H Bering *Helmut Kohl* (1999) 171. See also M Weiss & M Schmidt *Labour Law and Industrial Relations in Germany* (2008) 21.
[170] H Bering *Helmut Kohl* (1999) 176.
[171] H Bering *Helmut Kohl* (1999) 176.
[172] H Bering *Helmut Kohl* (1999) 176.
[173] U Wengenroth "The Rise and Fall of State-Owned Enterprises in Germany" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 103 119. See also JC Baker "Popular Capitalism through People's Shares in Germany" (1969) 4(2) *Columbia Journal of World Business* 63 63-67.
[174] H Christiansen *The Size and Composition of the SOE Sector in OECD Countries: OECD Corporate Governance Working Papers No 5* (2011) (available at http://dx.doi.org/10.1787/5kg54cwps0s3-en (visited on 4 February 2015). The OECD received responses to a questionnaire including various question on SOEs. See more statistics on SOEs in Germany in OECD *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (2014) 34 (available at http://dx.doi.org/10.1787/9789264215610-en).

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it had 57 majority-owned non-listed entities and two statutory corporations which were majority-owned by the federal government.[175] The federal government further had a minority share in Deutsche Telekom (31.7%), Deutsche Post (30.5%) and Commerzbank (25%).[176] Angela Merkel, the current German Chancellor, is not a proponent of big state intervention in the economy either. It is stated that "Angela Merkel['s] vision is of a Europe of shrivelled public ownership and a minimal welfare state."[177] Just like her two immediate predecessors, Helmut Kohl and Gerhard Schroeder, Angela Merkel remains committed to a privately run economy in Germany.[178]

2 3 France

2 3 1 Post-World War II SOEs

> "The major thrust of the program presented to the Assembly by Prime Minister Pierre Mauroy was the broadest set of nationalization projects ever undertaken at one stroke in a free market economy."[179]

France had three periods of nationalisation under left-wing governments, from 1936 until 1937, from 1945 until 1946 and in 1982. SOEs though were not an unknown concept before these periods,[180] because nationalisation already existed in France

[175] H Christiansen *The Size and Composition of the SOE Sector in OECD Countries: OECD Corporate Governance Working Papers No 5* (2011) 7 (http://dx.doi.org/10.1787/5kg54cwps0s3-en) (visited on 4 February 2015).
[176] H Christiansen *The Size and Composition of the SOE Sector in OECD Countries OECD Corporate Governance Working Papers No 5* (2011) 11 (http://dx.doi.org/10.1787/5kg54cwps0s3-en) (visited on 4 February 2015).
[177] G Simmer "Europe can't take four more years of Angela Merkel's Thatcherism" http://www.theguardian.com/commentisfree/2013/aug/21/angela-merkel-thatcherism-europe.
[178] G Christodoulakis "Privatization of State Assets in the Presence of Crisis" in G Christodoulakis (ed) *Managing Risks in the European Periphery Debt Crisis: Lessons from the Trade-off between Economics, Politics and the Financial Markets* (2014) 108 111.
[179] J-F Revel "The quiet revolution" (1981) 3 *McKinsley Quarterly* 48 50.
[180] E Chandeau "The Rise and Decline of State-Owned Industry in Twentieth Century France" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 185 185. See also M Berne & G Pogorel "Privatisation Experiences in France" in M Köthenbürger & H-W Sinn (eds) *Privatization Experiences in the European Union* (2006) 161 163; and HP De Vries & BH Hoeniger "Post-Liberation Nationalizations in France" (1950) 50(5) *Columbia Law Review* 629 630.

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during the French Revolution.[181] France's biggest post-World War II nationalisation programme started decades after the end of the war, although the provisional government which came to power immediately after the war under General Charles de Gaulle also implemented nationalisation as a policy.[182] A number of industries were nationalised soon after the war. Pinkney states that the first post-war national assembly already voted during its first five months in power for the nationalisation of the Bank of France,[183] four large deposit banks,[184] public utilities,[185] coal mines and two thirds of the leading insurance companies.[186] A major part of the banking industry became nationalised in December 1945,[187] while in July of the same year the state became the owner of Air France.[188] President Felix Gouin replaced General De Gaulle in January 1946 and he proposed the nationalisation of more industries, which included, inter alia, gas and electricity, all coal mines, the largest insurance companies and investment banks and mining.[189] In April of 1946 France's National Assembly adopted laws which implemented many[190] of President Gouin's proposals. Cohen states that as a consequence of the intensified nationalisation programme, the state's role in the economy was extensive and in 1946 "it directly controlled 98 percent of coal production, 95 percent of electricity, 58 percent of the banking sector,

[181] E Chandeau "The Rise and Decline of State-Owned Industry in Twentieth Century France" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 185 191.
[182] DH Pinkney "Nationalization of Key Industries and Credit in France after the Liberation" (1947) 62(3) *Political Science Quarterly* 368 368.
[183] See KR Bopp "Nationalization of the Bank of England and the Bank of France" (1946) 8(3) *Journal of Politics* 308 308-318.
[184] See MG Myers "The Nationalization of Banks in France" (1949) 64(2) *Political Science Quarterly* 189 189-210.
[185] See for example B Bliss "Nationalisation in France and Great Britain of the Electricity Supply Industry" (1954) 3(2) *International and Comparative Law Quarterly* 277 277-290.
[186] DH Pinkney "Nationalization of Key Industries and Credit in France after the Liberation" (1947) 62(3) *Political Science Quarterly* 368 368.
[187] E Chandeau "The Rise and Decline of State-Owned Industry in Twentieth Century France" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 185 181.
[188] DH Pinkney "Nationalization of Key Industries and Credit in France after the Liberation" (1947) 62(3) *Political Science Quarterly* 368 374-375.
[189] DH Pinkney "Nationalization of Key Industries and Credit in France after the Liberation" (1947) 62(3) *Political Science Quarterly* 368 375.
[190] The National Assembly voted in favour of many of President Gouin's proposed nationalisations, but other proposed nationalisations such as the nationalisation of the iron and steel industry were not implemented.
See E Chandeau "The Rise and Decline of State-Owned Industry in Twentieth Century France" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 185 189.
The bill on the nationalisation of the investment banks also never made it to the National Assembly. See DH Pinkney "Nationalization of Key Industries and Credit in France after the Liberation" (1947) 62(3) *Political Science Quarterly* 368 376.

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38 percent of automobile production, and 15 percent of total GDP."[191] Nationalisation during this period apparently benefited the French economy as it grew more rapidly than the United States economy, people had a high standard of living and unemployment was low.[192]

President Charles de Gaulle, the first president of the Fifth French Republic from 1958, continued the post-war nationalisation drive and another round of intensive nationalisations followed from 1981 until 1986 under the Socialist President, François Mitterrand.[193] Mitterrand was elected as the president of France in May 1981. He embarked on significant economic changes and the "centrepiece" of changes under Mitterrand was the "$7.4 billion nationalisation program".[194] The nationalisation plans under President Mitterrand are considered to be "the most ambitious plan ever carried out by a Western democracy."[195] Molnar states that Mitterrand's Socialist government believed that nationalisation would "expand the economy, since it was an article of faith with them that these institutions theretofore had served only the rich, but that under state ownership they would prosper because of the confidence of the masses in the Socialist program."[196] It is also stated that nationalisation was pursued in order to reorganise dysfunctional industries "central to economic development" in order for them to become more efficient, effective and productive.[197] Berne and Pogorel state that some of the reasons for the nationalisation of private enterprises included that some private enterprises performed poorly financially and provided "substandard services", some private enterprises were considered to be "too powerful or strategic" and therefore could not remain under private ownership and that the nationalisation of Renault, the French vehicle manufacturing company, was a "special case" as its head was considered to have been working with the Germans during World War II and therefore his property

[191] P Cohen "Lessons from the Nationalization Nation: State-Owned Enterprises in France" (2010) 57(1) *Dissent* 15 16.
[192] P Cohen "Lessons from the Nationalization Nation: State-Owned Enterprises in France" (2010) 57(1) *Dissent* 15 16.
[193] P Cohen "Lessons from the Nationalization Nation: State-Owned Enterprises in France" (2010) 57(1) *Dissent* 15 16.
[194] D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 422.
[195] RJ Nelson "Mitterand's Nationalization Plans" (1981) 24(5) *Challenge* 54 54.
[196] T Molnar "Utopia Collapses" (1985) 37 *National Review* 30 30.
[197] RF Durant & JS Legge Jr. "Politics, Public Opinion, and Privatization in France: Assessing the Calculus of Consent for Market Reforms" (2002) 62(3) *Public Administration Review* 307 311.

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had to be nationalised.[198] Another important factor was that most French people were in favour of nationalisation.[199] Prosser mentioned that "the French penchant for the drawing up of national plans has also contributed to the image of a nation in which the state takes a far more central role in the purposive process of economic management."[200]

Mitterrand's nationalisation programme commenced with the enactment of the "Nationalization Law", which initially went through some constitutional challenges but eventually was promulgated in 1982.[201] From the outset the intensity of Mitterrand's nationalisation drive appeared to be aimed at eliminating private capital in SOEs.[202] Some of the industries which were included in this round of nationalisations were banks,[203] companies in the steel, electricity, insurance and manufacturing industries.[204] In terms of Title I of the "Nationalization Law" five industrial companies were nationalised: Compagnie generale d'electricite; Compagnie de Saint-Gobain; Pechiney-Ugine-Kuhlmann; Rhone-Poulenc; and Thomson-Brandt. The state took transfer of all right, title and interest in the shares representing the companies' capital.[205] In exchange all holders of the shares which were transferred to the State received within three months after the publication of the "Nationalization Law, bonds

[198] See also M Berne & G Pogorel "Privatisation Experiences in France" in M Köthenbürger & H-W Sinn (eds) *Privatization Experiences in the European Union* (2006) 163 164.
[199] See D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 423 where they stated that polls done by two magazines amongst the French people showed "close to 50%" of the French were in favour of nationalisation. See also D Holter "Nationalization Reconsidered" (1986) 14 *French Politics and Society* 27 31 where it is stated that state economic intervention had broad support in France, inter alia, amongst small business, farmers and workers.
[200] T Prosser "Constitutions and Political Economy: The Privatisation of Public Enterprises in France and Great Britain" (1990) 53(3) *Modern Law Review* 304 305. See also P Cohen "Lessons from the Nationalization Nation: State-Owned Enterprises in France" (2010) 57(1) *Dissent* 15 16 for the reference to France as the "nationalisation nation" in the context of the 2008 recession in the United States when policy options had to be discussed on how to save certain industries and when nationalisation of certain industries were considered in order to save them from economic failure.
[201] D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 422.
[202] D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 422.
[203] D Cobham "The Nationalisation of the Banks in Mitterrand's France: Rationalisations and Reasons" (1984) 4(4) *Journal of Public Policy* 351 351-358.
[204] P Cohen "Lessons from the Nationalization Nation: State-Owned Enterprises in France" (2010) 57(1) *Dissent* 15 16. See also E Chandeau "The Rise and Decline of State-Owned Industry in Twentieth Century France" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 185 188; and D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 422-427.
[205] "Article 2 of the Law of Nationalization No. 82-155 of 11 February 1982" (1982) 21(4) *International Legal Materials* 815 815.

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which were issued by the National Industrial Fund, a fund which was also established by the "Nationalization Law".[206] Title II of the "Nationalization Law" dealt with the nationalisation of banks. Banks that were included in the programme included those that were registered with the National Credit Council in terms of the laws of France and had on 2 January 1981 either one billion francs or more in demand deposits or in liquid or short-term investments.[207] At least 40 banks were nationalised in terms of this law.[208] However, certain banks were excluded from the programme. Examples included banks in which the majority of voting shares were owned by a natural person who was not residing in France or a juristic person whose "home office" was not in France.[209] The nationalisation process took the same form as with other companies. The nationalisation of the banks heavily increased the state's involvement as a deposit holder. Borde and Egglestone state that before the bank nationalisations, the already state-controlled banks accounted for 58.6 percent of deposits, while after the nationalisations this number increased to 98 percent. Title III of the "Nationalization Law" dealt with the nationalisation of two financial companies namely Compagnie financiere de Paris et des Pays-Bas; and Compagnie financiere de Suez.[210]

Mitterrand's nationalisation programme did not only focus on the enterprises listed in the "Nationalization Law". Some enterprises which were not listed in the statute were also nationalised.[211] During the early years of the nationalisation programme, the French public sector accounted for "24% of employees, 32% of sales, 30% of exports and 60% of annual investment in the industrial and energy sectors".[212] Nationalisation in France continued unabated for a number of years under

[206] "Article 4 of the Law of Nationalization No. 82-155 of 11 February 1982" (1982) 21(4) *International Legal Materials* 815 815.
[207] "Article 12 of the Law of Nationalization No. 82-155 of 11 February 1982" (1982) 21(4) *International Legal Materials* 815 818. See also D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 423.
[208] For a list of the banks that were nationalised see Article 12 of the Law of Nationalization No. 82-155 of 11 February 1982 (1982) 21(4) *International Legal Materials* 815 818.
[209] "Article 12 of the Law of Nationalization No. 82-155 of 11 February 1982" (1982) 21(4) *International Legal Materials* 815 818.
[210] "Article 29 of the Law of Nationalization No. 82-155 of 11 February 1982" (1982) 21(4) *International Legal Materials* 815 823.
[211] For examples see D Borde & WW Egglestone "The French Nationalizations" (1982) 68 *American Bar Association Journal* 422 424.
[212] M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50(6) *Business History* 795 801.

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Mitterrand's administration. This position was somewhat reversed in the late 1980s when it became clear that instead of assisting the French economy, Mitterrand's nationalisations were doing the opposite. Unlike the positive growth which was observed after the 1945-1946 nationalisations, the Mitterrand administration's nationalisation increased the woes of the French economy. During the first years of nationalisation, unemployment was high and private investment in France fell sharply, which impacted on competitiveness.[213]

2 3 2 Divestiture of state assets in France

It was time to end France's reputation as an "interventionist" state. When Jacques Chirac became the French Prime Minister in 1986, nationalisation soon became part of France's economic history. Privatisation of SOEs replaced it as a policy objective during the governments of Laurent Fabius,[214] Jacques Chirac, Edouard Balladur[215] and Alain Juppe.[216] The high-water mark of state divestiture was reached during the tenure of Jacques Chirac. Laux states that the privatisation of SOEs was a priority of the Chirac government and that the aim was to establish a free and competitive economy.[217] It is stated that the policies of the French conservatives, of which Chirac was one, was to "restrict the role of the state to shift the interests and attention of business from the Ministry of Finance to the stock market and to transform France into a country of shareholders."[218]

The intention of the conservative government was clearly expressed when it established a Ministry of Industry, Trade and Privatization.[219] On 11 February 1986 a privatisation programme was adopted.[220] It aimed at reducing government involvement in most industrial and financial enterprises while those enterprises with

[213] RJ Monsen "French Socialists March to the Right" (1984) 27(4) *Challenge* 37 38.
[214] Prime Minister of France from 1984 until 1986. See B Jacquillat *Nationalization and Privatization in Contemporary France* (1988) 11-12.
[215] Prime Minister of France 1993 until 1995.
[216] Prime Minster of France 1995 until 1997.
[217] JK Laux "Privatization and France's Aerospace Industry: Limits to Liberalism" (1987) 5(4) *French Politics and Society* 27 27.
[218] N Spulber *Redefining the State: Privatization and Welfare Reform in Industrial and Transitional Economics* (1997) 88.
[219] D Holter "Nationalization reconsidered" (1986) 14 *French Politics and Society* 27 27.
[220] "France: Laws concerning the privatization of nationalised enterprises" (1987) 26(5) *International Legal Materials* 1388 1388.

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a "public service" were not initially included.[221] Earmarked for privatisation in the government policies were banks, financial institutions and industrial companies.[222] Initially 66 SOEs were to be privatised during the first five years of the privatisation programme.[223] It is argued that the reduction in state intervention that was about to take place in France was in line with Margaret Thatcher's privatisation programme in Great Britain and Ronald Reagan's deregulation of business in the United States.[224]

The aim with this privatisation programme was to reverse some of the nationalisations of the early presidency of Mitterrand but the laws adopted in order to embark on this privatisation programme, did not only include enterprises which were nationalised during this period, but also those which were nationalised by the De Gaulle administration after World War II.[225] Some of the first SOEs that were privatised included the "industrial companies" Compagnie de Saint-Gobain, Pechiney-Ugine-Kuhlmann; Rhone-Poulenc as well as the nationalised banks Banque Odier, Bungener, Courvoisier and Banque Paribas.[226] In almost all cases the government used "public share offerings" to sell its assets.[227] Privatising SOEs meant that the enterprise would enter the free market for investments and anyone who could afford it, could buy shares in them. Initially the government wanted desirable shareholders to take up the public share offerings and measures were put in place to achieve this. These measures included for example that foreigners could obtain only 20 percent of issued shares and that the government could issue itself a "special share", which would allow it a veto right in regard to any shareholder.[228]

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[221] D Parker "Privatization in the European Union: A Critical Assessment of its Development, Rationale and Consequences" (1991) 20 *Economic and Industrial Democracy* 9 11.
[222] "France: Laws concerning the privatization of nationalised enterprises" (1987) 26(5) *International Legal Materials* 1388 1388.
[223] M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50(6) *Business History* 795 801.
[224] D Holter "Nationalization reconsidered" (1986) 14 *French Politics and Society* 27 27.
[225] "France: Laws concerning the privatization of nationalised enterprises" (1987) 26(5) *International Legal Materials* 1388 1388.
[226] E Chadeau "The Rise and Decline of State-Owned Industry in Twentieth Century France" in PA Toninelli (ed) *The Rise and Fall of State-Owned Enterprises in the Western World* (2000) 185 201; and also "France: Laws concerning the privatization of nationalized enterprises" (1987) 26(5) *International Legal Materials* 1388 1394. See also M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50(6) *Business History* 795 797 for a list of the fifteen largest privatised companies in 1998.
[227] J Laux "Privatization and France's Aerospace Industry: Limits to Liberalism" (1987) 5(4) *French Politics and Society* 27 27.
[228] J Laux "Privatization and France's Aerospace Industry: Limits to Liberalism" (1987) 5(4) *French Politics and Society* 27 28.

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Even though the privatisation programme slowed down when the French "father of nationalisation", Mitterrand, was re-elected as President in 1988, it did not completely disappear. During his second term in office Mitterrand followed a "neither privatizations nor nationalizations" approach.[229] The privatisation programme picked up speed again when Balladur became the Prime Minister in 1993. Even foreign investors from outside the EU could obtain 20 percent shareholding in the privatised enterprises.[230]

When Alain Juppe became the Prime Minister and Mitterrand was replaced by Jacques Chirac as President in 1995, privatisation in France reached new heights even though it did not always go smoothly. In order to comply with newly implemented European integration requirements which were set out at the time in the Treaty on European Union of 1992 (also referred to as the Maastricht treaty and hereinafter the TEU), Chirac and Juppe had to take certain measures in France. In terms of the new EU requirements member states were required to avoid excessive government deficits and the planned or actual annual government deficit was not allowed to exceed 3 % of a member state's GDP for that year.[231] The government debt in relation to the GDP of member states was also not allowed to exceed 60% in any year.[232] These new EU requirements were meant to ensure closer coordination of economic policies and sustained convergence of the economic performances of the member states.[233] They were implemented with the intention to adopt in the future an EU-wide economic and monetary policy[234] based on close coordination of member states' economic policies, the internal market, common objectives and the principle of an open market economy with free competition.[235] It was also to ensure

[229] M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50(6) *Business History* 795 802. See also RF Durant & JS Legge Jr. "Politics, Public Opinion, and Privatization in France: Assessing the Calculus of Consent for Market Reforms" (2002) 62(3) *Public Administration Review* 307 312.
[230] M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50(6) *Business History* 795 802.
[231] See Article 104 (c) of the Treaty on the European Union and the Protocol on the Excessive Deficit Procedure which forms part of this treaty. See also the Stability and Growth Pact, which was adopted in June 1997 by the European Council and is described as a "set of rules designed to ensure that countries in the European Union pursue sound public finances and coordinate their fiscal policies."
[232] See Article 1 of the Protocol on the Excessive Deficit Procedure in the Treaty on the European Union.
[233] Article 103 (3) of the TEU.
[234] This culminated in the European Economic and Monetary Union (EMU) in 1992. See M Chang *Economic and Monetary Union* (2016) for more on the EMU.
[235] Article 3 a(1) of the TEU.

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that there would be compliance with the principles of stable prices, sound public finances and monetary conditions and a sustainable balance of payments.[236]

One measure taken by Chirac and Juppe was to cut jobs within SOEs and the civil service. Durant and Legge, Jr state that "one out of five French citizens in the workforce was paid directly by the state before the Gaullist privatization initiatives began under Chirac and Juppe."[237] Consequently this led to public-sector strikes by the French union movement.[238] Such actions by employees in the public sector did however, not stop the privatisations of SOEs. By 1997, when another socialist Prime Minister, Lionel Jospin, came to power; "public assets exceeding $40 billion in value" had been sold through privatisation.[239] Any fears that the new socialist-led government would reverse the privatisations did not materialise. However, Jacques Chirac, unsure of what would become of the privatisation programme started by him, still issued a stern warning to the socialists by saying:

> "The state today no longer has any place in the management of competitive industry." That was a debate from another age." [240]

Jospin initially hesitated to sell state assets.[241] However, the Jospin government accepted the position it found regarding privatisation and it continued with the selling of state assets. The Jospin administration, however, did not refer to it as "privatisation" but as "capital opening".[242]

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[236] Article 3 a(3) of the TEU.
[237] RF Durant & JS Legge Jr. "Politics, Public Opinion, and Privatization in France: Assessing the Calculus of Consent for Market Reforms" (2002) 62(3) *Public Administration Review* 307 313.
[238] RF Durant & JS Legge Jr. "Politics, Public Opinion, and Privatization in France: Assessing the Calculus of Consent for Market Reforms" (2002) 62(3) *Public Administration Review* 307 313.
[239] M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50(6) *Business History* 795 802.
[240] B James "Privatization is Essential, Chirac Warns Socialists: Resisting Global Currents, France Sticks to Being French" *New York Times* (15 July 1997).
[241] M Berne & G Pogorel "Privatisation Experiences in France" in M. Kothenburger H-W Sinn & J Whalley (eds) *Privatization Experiences in the European Union* (2006) 163 168.
[242] M Maclean "New rules – old games? Social capital and privatisation in France, 1986–1998" (2008) 50 (6) *Business History* 795 802. See also RR Miller *Doing Business in Newly Privatized Markets: Global Opportunities and Challenges* (2008) 111; and M Berne & G Pogorel "Privatisation Experiences in France" in M Kothenburger, H-W Sinn & J Whalley (eds) *Privatization Experiences in the European Union* (2006) 163 168.

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2 3 3 SOEs in present-day France: the position from 1997 onwards

Privatisation used to be a policy mostly accepted and executed by "right-wing governments" but it has become the "conventional wisdom", even of the left.[243] France illustrates this point, with Mitterrand, a socialist executing most of the nationalisations while Lionel Jospin, also a socialist, continued with the privatisations. Jospin went on to privatise more state assets than his five immediate predecessors combined and while his immediate predecessors privatised "easy targets", he even disposed of strategic industries and public services.[244] Part of France Telecom,[245] which was considered to be the fourth biggest telecom operator in the world, was privatised in 1997 and after restructuring, Air France was sold in 1999.[246] Privatisation in the financial sector followed in 1998 with a partial selling of assets in the insurance enterprise, CNP Assurances and the selling of shares in Credit Lyonnais, a French bank.[247] The privatisation of Credit Lyonnais was in part expedited due to the EU Competition Commissioner's plans to accept a state aid package allocated to the bank if privatised.[248] Plans to privatise enterprises in the defence sector such as Thomson-CSF, a defence electronic group and Aerospatiale, an aerospace company were also put in place.[249] European integration was a big driving force behind France's privatisation programme. Another factor which is indicated as important in regard to French privatisations is the EU prohibition of state aid to public undertakings, without consent from the European Commission.[250] It is observed that due to this ban, public enterprises needed to find private enterprises within the EU or outside of the EU to work with and consequently privatisation and globalisation took place simultaneously.[251] The ban on public support for public enterprises will be discussed in chapter four. It suffices to state at this point that state aid to public enterprises within the EU is regulated by the EU's detailed State Aid

[243] Y Tiberghien *Entrepreneurial States: Reforming Corporate Governance in France, Japan, and Korea* (2007) 91.
[244] RR Miller *Doing Business in Newly Privatized Markets: Global Opportunities and Challenges* (2008) 109.
[245] F Degeorgea, D Jenterb, A Moelc & P Tufanoe "Selling company shares to reluctant employees: France Telecom's experience" (2004) 71 *Journal of Financial Economics* 169 170.
[246] RR Miller *Doing Business in Newly Privatized Markets: Global Opportunities and Challenges* (2008) 110.
[247] RR Miller *Doing Business in Newly Privatized Markets: Global Opportunities and Challenges* (2008) 110.
[248] MR Gueldry *France and European Integration: Toward a Transnational Polity?* (2001) 76.
[249] RR Miller *Doing Business in Newly Privatized Markets: Global Opportunities and Challenges* (2008) 111.
[250] MR Gueldry *France and European Integration: Toward a Transnational Polity?* (2001) 79.
[251] MR Gueldry *France and European Integration: Toward a Transnational Polity?* (2001) 79.

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policy, which has its legislative origin in Article 107[252] and 108[253] of the Treaty on the Functioning of the European Union.

The OECD states that the "large economies" in Europe, which includes France, has seen the most privatisations from 2000 onwards.[254] From 2000 until 2007 France has sold state assets worth US$98.2billion, which places it at the top of the OECD's list of "Top-10" countries in regard to privatisation activities.[255] France's privatisation drive is continuing into the 21st century. In 2004 it started with the privatisation of France Telecom when 10.9 percent of the company's shares were transferred; 2005 saw also privatisation activities in regard to Electricite de France, an electric utility, and motorway operators Autoroutes du Sus de la France and Autoroutes Paris-Rhin-Rhone.[256] Since the first privatisations during Jacques Chirac's time as Prime Minister, France has come a long way with privatisation. Whether it was a conservative or socialist leading France, privatisation remained part of French economic policy; the opposite of post-World War II France, when nationalisation was an integral part of economic policy in order to rebuild the country after the devastating war.

Nicholas Sarkozy, who succeeded Jacques Chirac as president of France in May 2007, readjusted his "free market leanings" during the 2008 financial crisis which hit the French economy hard by sending it into a prolonged and "severe recession", the first since 1993.[257] It caused mass unemployment in France, the public deficit

[252] ex Article 89 of the Treaty Establishing the European Communities.
[253] ex Article 88 of the Treaty Establishing the European Communities.
[254] See OECD *Privatisation in the 21st Century: Recent Experiences of OECD Countries: Report on Good Practices* (2009) (accessible at www.oecd.org/daf/corporateaffairs).
[255] See OECD *Privatisation in the 21st Century: Recent Experiences of OECD Countries: Report on Good Practices* (2009) 7 (accessible on www.oecd.org/daf/corporateaffairs).
[256] See OECD *Privatisation in the 21st Century: Recent Experiences of OECD Countries: Report on Good Practices* (2009) 10 (accessible on www.oecd.org/daf/corporateaffairs).
[257] D Eckert, F Escaffre & J Tallec "A French region in crisis: The response of local authorities to the recession in the Region Midi- Pyrenees in France" in D Bailey & C Chapain (eds) *The Recession and Beyond Local and Regional Responses to the Downturn* (2011) 288 288. See also International Monetary Fund *France : 2009 Article IV Consultation: Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for France* (2009)
(available at https://www.imf.org/en/Publications/CR/Issues/2016/12/31/France-2009-Article-IV-Consultation-Staff-Report-Public-Information-Notice-on-the-Executive-23149).

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worsened and many businesses went into bankruptcy.[258] Sarkozy became critical of the "dictatorship of the market" and noted that "Laissez-faire capitalism is over".[259] Sarkozy had to take measures (i) to reduce the public deficit; (ii) to limit job losses; and (iii) to prevent business closures.[260] It would however be unfair towards Sarkozy to argue that measures taken during the financial crisis made him a proponent of state intervention in the economy.[261] Many other developed countries such as the USA, Britain and Germany also had to take measures to protect their economies during the financial crisis and this did not necessarily signal a broad policy change towards greater state intervention.

François Holland, who succeeded Sarkozy as the President of France and who is also known as the "most unpopular President of the Republic's seven Presidents",[262] did not take an interventionist approach during his time in office even while the French economy suffered severely because of the 2008 financial crisis and the "euro zone" economic crisis. Kuhn states that while "French voters may not have appreciated the hyperactive interventionism of President Sarkozy, this did not mean that they wanted their president to stand back from taking responsibility at a time of severe economic problems."[263] In May 2017 France elected Emmanuel Macron, a former Minister of Economy, Industry and Digital Affairs in President Francois Hollande's administration, as its President.[264] At the time France had faced years of "economic stagnation and political failure": France's GDP growth was behind most of other larger economies in Europe, unemployment was high and poverty rates

[258] D Eckert, F Escaffre & J Tallec "A French region in crisis: The response of local authorities to the recession in the Region Midi- Pyrenees in France" in D Bailey & C Chapain (eds) *The Recession and Beyond Local and Regional Responses to the Downturn* (2011) 288 288.
[259] P Kubicek *European Politics* 2nd ed (2017) 251.
[260] D Eckert, F Escaffre & J Tallec "A French region in crisis: The response of local authorities to the recession in the Region Midi- Pyrenees in France" in D Bailey & C Chapain (eds) *The Recession and Beyond Local and Regional Responses to the Downturn* (2011) 288 292.
[261] This observation is supported by J Levy "The Return of the State? French Economic Policy under Nicolas Sarkozy", Unpublished paper presented at the 106th annual meeting of the American Political Science Association, Washington D.C., 2-5 September 2010.
(available at https://ssrn.com/abstract=1902856). Levy points out three constraints to state intervention in France during Sarkozy's administration and these include (i) institutional capacity, (ii) fiscal capacity and (iii) electoral considerations. See also R Kuhn "Mister Unpopular: Francois Hollande and the Exercise of Presidential Leadership, 2012-2014" (2014) 22(4) *Modern and Contemporary France* 435 435-457.
[262] J Gaffney *France in the Hollande Presidency: The Unhappy Republic* (2015) 2.
[263] R Kuhn "Mister Unpopular: Francois Hollande and the Exercise of Presidential Leadership, 2012-2014" (2014) 22(4) *Modern and Contemporary France* 435 444.
[264] M Ma "Note of the French Presidential Elections of 2017" 11 (2017) *Journal of Parliamentary and Political Law* 963 694

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rose.[265] When President Macron took office, the economic conditions in France started to improve slowly.[266] Some of his policies for a renewed economy and prosperity for the French people include the cutting of taxes and spending, less red tape in regard to French labour laws and to reduced unemployment.[267] Most importantly for this study, is that privatisation of SOEs became firmly part of President Macron's economic policy to further boost the French economy.[268] In 2017 the government sold a "block of shares" in Engie, the power and gas company and in October 2018 it sold a €1.24 billion stake in Safran, the French aerospace and defence company.[269] However, not all of President Macron's economic policies are without controversy. Recent events in France, shows significant unhappiness with some of his economic policies. Eighteen months into his administration President Macron faced the first challenge to some of his economic policies when large protests erupted in November 2018 throughout the country and still continues to this day, although with rather small numbers than when it initially started. The protesters, who became known as the "Yellow Vests", protested against ever increasing fuel prices and taxes which President Macron announced as measures to "protect the environment" and "combat climate change". Furthermore, opposition groups are up in arms against privatisation plans of big SOEs.[270] It is submitted that the willingness of President Macron's government to sell stakes in big state-owned giants such as Groupe ADP, the national airport operator and the energy firm Engie, shows that he might have a stance towards state ownership much like that of Jacques Chirac.

3 SOEs in a developing country: The case of South Africa

3 1 Introduction

[265] R Tiersky "Macron's World: How the New President is Remaking France" 2018 97(1) *Foreign Affairs* 87 89.
[266] R Tiersky "Macron's World: How the New President is Remaking France" 2018 97(1) *Foreign Affairs* 87 89.
[267] M Ma "Note of the French Presidential Elections of 2017" 11 (2017) *Journal of Parliamentary and Political Law* 963 694.
[268] See Z Young "France's Le Maire set to unveil inflammatory privatization bill" (available on www.politico.eu).
[269] S Kerr "France sells slice of Safran as part of Macron privatisation drive" GlobalCapital 10/22/2018
[270] See Z Young "France's Le Maire set to unveil inflammatory privatization bill" (available on www.politico.eu).

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SOEs were created in South African long before the dawn of Apartheid. Southall is of the opinion that the rise of SOEs in South Africa started during the reign of the "Pact Government",[271] which ruled South Africa from 1924 to 1929.[272] The Electricity Supply Commission (ESCOM), which was created in 1922 by the Electricity Act of 1922,[273] and the Iron and Steel Corporation (Iscor), which was created in 1928,[274] were two of South Africa's first SOEs.[275] More SOEs were created when the Reunited National Party (which two years later became the National Party) became the ruling party in 1948.[276] The sectors in which state ownership became more prominent were oil, gas, coal and arms.[277] Privatisation only became a policy during P. W. Botha's reign as head of state. He wanted certain SOEs to become profit-making entities.[278] Other reasons given for the apartheid government's decision to take the route of privatisation is said to be that privatisation was an attempt by the National Party to manage South Africa's transition from Apartheid to democracy by limiting the ANC's power.[279] Privatisation also ensured a growing free market economy but it only promoted the interest of the same people that accumulated all the advantages during Apartheid.[280]

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[271] The Pact Government refers to the coalition government of Hertzog's National Party and Cresswell's Labour Party which came into power in 1924. For more on the Pact Government see J Seekings "'Not a single white person should be allowed to go under': Swartgevaar and the origins of South Africa's welfare state', 1924-1929" (2007) 48 *Journal of African History* 375 375–394; and H Giliomee *The Afrikaners: Biography of a People* (2003) 336.

[272] R Southall, "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 203. See also R Christie *Electricity, Industry and Class in South Africa* (1985) 93.

[273] V Gumede *Political Economy of Post-Apartheid South Africa* (2015) 80. Mining is considered to have been the catalyst for the development of the electricity supply industry in South Africa. See RJ Khoza & M Adam "The Structure and Governance of Eskom: a case study" in CA Mallin (ed) *International Corporate Governance: A Case Study Approach* (2016) 284 285.

[274] HS Jones & A Muller *The South African Economy, 1910–90* (1992) 75.

[275] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 202.

[276] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 203.

[277] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 202.

[278] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 205.

[279] JJ Hentz "The two faces of privatisation: political and economic logics in transitional South Africa" (2000) 38(2) *Journal of Modern African Studies* 203 212.

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When South Africa became a democracy, nationalisation was firmly on the agenda of the governing ANC.[281] Nelson Mandela, South Africa's first democratically elected president, also started out as a stern believer in nationalisation, but he came to accept that the free market is the best option to grow South Africa's economy. This became clear when he said the following on 12 November 2003 during a symposium in the United States:

> "When I was released from prison, I announced my belief in nationalisation as a cornerstone of our economic policy. As I moved around the world and heard the opinions of leading businesspeople and economists about how to grow an economy, I was persuaded and convinced about the free market. The question is how we match those demands of the free market with the burning social issues of the world."[282]

In essence Mandela's words, when applied to SOEs, reflect the major concern of this thesis. SOEs that receive public funds become a burden on taxpayers, often are corrupt and inefficient and undermine effective competition with private enterprises. Nevertheless, these enterprises can be important instruments to address the almost insurmountable social problems facing South Africa. It will be difficult to set out rules that will promote the benefits of these enterprises while limiting the harm that they may do. Hence, the role of SOEs in South Africa and some of South Africa's most significant SOEs will now be discussed in order to provide background to the evaluation of these issues.

3 2 The role of SOEs in South Africa

According to Levy the development of SOEs in South Africa can be divided into four "broad phases".[283] The first phase stretches from the time when the State took

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[280] JJ Hentz "The two faces of privatisation: political and economic logics in transitional South Africa" (2000) 38(2) *Journal of Modern African Studies* 203 212.
[281] It formed part of the ANC's Freedom Charter. See para 3 4 of this chapter for the reference to the Freedom Charter.
[282] N Mandela *Nelson Mandela By Himself: The Authorised Book of Quotations* (2011) 247.
[283] B Levy "Commanding heights: The Governance of State-owned Enterprises in Contemporary South Africa" in H Bhorat, A Hirsch, R Kanbur & M Ncube (eds) *The Oxford Companion to the Economics of South Africa* (2014) 202 203.

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control of the railways after the Anglo-Boer War until the 1960s.[284] During this time Iscor, ESCOM, the Industrial Development Corporation (IDC) and the South African Coal, Oil and Gas Corporation (Sasol)[285] were established.[286] The second phase refers to the time during the 1980s,[287] which is also the time when Iscor was privatised. During that time PW Botha, the State President at the time, announced his intentions of implementing privatisation as a government policy.[288] Levy considers the third phase to be the first few years after the transition from Apartheid to democracy during which the ANC-led government was willing to keep up with world developments to embrace commercialisation[289] and restructuring of SOEs.[290] Levy's last phase regarding the role of SOEs in the South Africa economy refers to the time from 2007 until the present day, which takes into account the powerful rise of China as a world economy and the 2008 financial crisis which impacted on the "superiority of market capitalism.[291] Perhaps a further epoch namely the era of "state capture" and the damage that this has done to the sustainability and credibility of SOEs can be added to those distinguished by Levy.

As in the case of the European countries discussed above, the existence of SOEs in South Africa also needs to be viewed and discussed within the context of South Africa's recent political and economic past. Due to Apartheid policies, the greater

[284] B Levy "Commanding heights: The Governance of State-owned Enterprises in Contemporary South Africa" in H Bhorat, A Hirsch, R Kanbur & M Ncube (eds) *The Oxford Companion to the Economics of South Africa* (2014) 202 202- 203.
[285] ESCOM/Eskom, ISCOR, the IDC and SASOL are discussed in para 3 3 of this chapter.
[286] B Levy "Commanding heights: The Governance of State-owned Enterprises in Contemporary South Africa" in H Bhorat, A Hirsch, R Kanbur & M Ncube (eds) *The Oxford Companion to the Economics of South Africa* (2014) 202 203.
[287] B Levy "Commanding heights: The Governance of State-owned Enterprises in Contemporary South Africa" H Bhorat, A Hirsch, R Kanbur & M Ncube (eds) *The Oxford Companion to the Economics of South Africa* (2014) 202 203.
[288] E Schwella "Privatization in South Africa" in D Parker & D Saal (eds) *International Handbook On Privatization* (2003) 291 293.
[289] Commercialization meant that the SOE could "generate profits and pay taxes, received no state subsidies, and was responsible for obtaining its own financing" See *Competition Commission v Telkom SA Ltd* [2012] 2 CPLR 334 (CT) 340. This observation was made by the Competition Tribunal of South Africa in the context of Telkom. It is submitted that it is however reasonable to say that this observation can be made in regard to other SOEs as well which have been commercialised.
[290] B Levy "Commanding heights: The Governance of State-owned Enterprises in Contemporary South Africa" in H Bhorat, A Hirsch, R Kanbur & M Ncube (eds) *The Oxford Companion to the Economics of South Africa* (2014) 202 203.
[291] B Levy "Commanding heights: The Governance of State-owned Enterprises in Contemporary South Africa" in H Bhorat, A Hirsch, R Kanbur & M Ncube (eds) *The Oxford Companion to the Economics of South Africa* (2014) 202 203.

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part of the South African population had been excluded from socio-economic advancement. These policies also led to South Africa being isolated by the rest of the world. The impact of isolation on South Africa's economy was marked. It had become more or less self-reliant. South Africa's self-reliance at the time can be seen either as an advantage if that was the reason for the South African government to develop its own industry or it can be considered a disadvantage considering the massive funding the government had to find to finance its self-reliance and industrial development. In its determination to become self-reliant and to ensure that the economy did not falter, the Apartheid government became heavily involved in the economy. SOEs were established and used to ensure self-reliance while these SOEs also assisted the apartheid government in enforcing some of their other policies. An SOE like Armscor, for example, assisted the apartheid government with keeping political unrest in Soweto under control in 1976 through the use of locally manufactured weapons[292] while a SOE like Sasol ensured that South Africa had sufficient oil supplies after Iranian oil supplies to South Africa were discontinued following the fall of the Shah during the Islamic Revolution.[293] SOEs were used to develop infrastructure and to keep people content through job creation. Southall states that the extension of the state sector after 1948 led to (i) the appointment of "Afrikaner businessmen in key positions" in SOEs, (ii) "Afrikaners [being] favoured for the public service and senior and middle-management position within the parastatals",[294] and (iii) SOEs being used by the National Party "to develop Afrikaner capital". SOEs were also used to provide services and goods to the public. Most of the services and goods delivered by SOEs were aimed at the minority white

[292] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) xi.
[293] HE Chehabi "South Africa and Iran in the Apartheid Era" (2016) 42(4) *Journal of Southern African Studies* 687 687-709. The Shah had good political and economic relations with Apartheid South Africa and did not join in any oil embargo placed on South Africa by Arab countries and the Organisation of Petroleum-Exporting Countries' (OPEC) members (or the international community). Chehabi argues that this good relation originates from the "emotional tie" of the Shah with South Africa, since Reza Shah, his father, died in exile in Johannesburg in 1944. Also, the agreement which the Shah facilitated between the National Oil Company of Iran and Sasol (together with a French company) to establish a refinery (the Nasref refinery) in Sasolburg, in terms of which the National Oil Company of Iran supplied crude oil for twenty years, also facilitated the continuation of oil supplies to South Africa during the reign of the last Shah. Chehabi states that the Shah used Iran's "long-term national interest" to counter all criticism of its cooperation with Apartheid South Africa during a time of international sanctions against that regime. Conversely "Iranian revolutionaries … were united in their implacable hostility to the apartheid state."
[294] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 201-203.

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population as the Competition Tribunal (the Tribunal) observed in *Telkom SA Ltd /Business Connexion Group Ltd*.[295]

> "Under the old apartheid regime, it [Telkom] provided services to the residential and corporate market on the basis of the policies of that regime. Hence it was rare indeed to find residential telephone services in black townships."[296]

The same applied to many other enterprises with large infrastructure. Levin and Weiner state that Eskom "[built] the pylons that march past African villages to white farms" while the Land Bank provided subsidised credit to large farms owned by white South Africans.[297] South Africa thus had many SOEs as a result of the government's involvement in the Apartheid economy.

South Africa became an inclusive democracy when it had its first general election in 1994, but Apartheid has left South Africa with a deep divide between the rich and the poor. Although the ANC obtained political power in South Africa, economic power and the wealth of the country was still concentrated within the hands of a small white minority. The ANC-led government was and is still faced with high and often worsening levels of inequality, unemployment and poverty.

Through its policies, the ANC has attempted to address inequality, unemployment and poverty while extending the provision of public services to more South Africans.[298] It has tried to achieve a more equal distribution of wealth in South Africa. The provision of essential services and goods to all the people of South Africa was and remains a priority for the ANC.

The government felt that this could not be done without considerable government intervention in the economy. As stated by the Constitutional Court in *Competition*

[295] [2007] 2 CPLR 433 (CT).
[296] *Telkom Ltd /Business Connexion Group Ltd* [2007] 2 CPLR 433 (CT) 440.
[297] R Levin & D Weiner *No More Tears: Struggles for Land in Mpumalanga South Africa* (1997) 198.
[298] See in this regard N Gumede & K Asmah-Andoh "Prescriptions of the National Development Plan for State-Owned Enterprises in South Africa: Is Privatisation an Option?" (2016) 51(2) *Journal of Public Administration* 265 265-277.

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Commission v Senwes Limited Case CCT,[299] the majority of black people were excluded from participation in the economy by Apartheid laws. This needs to be corrected. The court also stated that the Preamble of the Competition Act "calls for the opening up of the economy to enable all South Africans to have access to the control and ownership of the national economy." In order to achieve this, the State has to intervene in the economy.

SOEs have become an important form of intervention in the economy for the post-Apartheid government. The ANC inherited a significant number of SOEs from the apartheid state. Through the continued use of these SOEs, and also by creating new ones, the government attempts to provide essential services and goods to all South Africans regardless of their race or social status.[300] SOEs in South African are therefore supposed to be "agents of development".[301]

Southall states that the enterprises inherited by the ANC government were of all kinds and included financial bodies, industrial undertakings and utility companies.[302] These SOEs are now used, inter alia, as instruments to correct the divide between rich and poor, to create employment and to ensure equal provision of essential goods and services at affordable rates to the people of South Africa. SOEs also provide the government with the opportunity to place previously disadvantage people in managerial positions, create employment equity for black people, woman and people with disabilities and create a first job opportunity for black university

[299] *Competition Commission v Senwes Limited Case* CCT 61/11 [2012] ZACC 6.
[300] Eskom, Telkom, SAA and Petro SA are examples of SOEs which the government uses to take part in economic activity. The ANC does regular research on the viability of creating an SOE in a particular industry or nationalising existing enterprises. In the recent past the ANC was looking into the possibility of establishing a state-owned pharmaceutical company to provide antiretrovirals to South Africans living with the human immunodeficiency virus (HIV). See "Govt mulls state pharmaceutical company" 19 July 2011 (www.mg.co.za) (accessed on 5 January 2015). The government also launched a state-owned mining company called the African Exploration Mining and Finance Corporation. See "SA launches state mining company", 25 February 2011 (www.mg.co.za) (accessed on 5 January 2015).
[301] This is a concept used by the OECD when referring the SOEs in some countries. See OECD (2015), State-Owned Enterprises in the Development Process, OECD Publishing.
(accessible on http://dx.doi.org/10.1787/9789264229617-en).
[302] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 206.

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graduates.[303] The government also uses SOEs to promote the equal distribution of resources especially since economic power is still to a large degree concentrated in the hands of a small white minority. Through SOEs such as Eskom, the government ensures strategically important sectors are developed for the benefit of all South Africans. A former Minister of Public Enterprises, Malusi Gigaba, stated that "the fundamental issue in determining whether the State needs to make a direct investment in a commercial enterprise is whether the private sector can be trusted to behave responsibly in developing a sector, particular if government regulatory capacity is weak."[304] In the absence of regulation in a sector, maintaining an enterprise within a sector might be the State's way of ensuring that the sector is not exploited for the benefit of a few privileged South Africans. Gigaba also stated that "SOEs had an important role to play in developing vital economic infrastructure, managing state assets, and driving the transformation of customers and suppliers."[305] The role attributed to SOEs by Gigaba is clearly visible in the infrastructure development of SOEs such as Eskom and Transnet.[306]

Decisions on whether to retain or divest the SOEs inherited from the Apartheid government, or whether to establish new SOEs or to nationalise private enterprises are informed by these policies. These governmental policies, which are the driving force behind the government's developmental agenda, together with the ANC's political ideology, are the reason for the continued use of and support of SOEs during the administrations of Presidents Nelson Mandela, Thabo Mbeki, Jacob Zuma and now Cyril Ramaphosa. These different administrations started or continued to operate SOEs in key sectors of the economy.[307] SOEs were used as important vehicles for achieving policy goals and complying with social responsibilities of

[303] A Pitcher "Was privatisation necessary and did it work? The case of South Africa" (2012) 39(132) *Review of African Political Economy* 243 249.
[304] See "Parastatals has an important role to play", says Gigaba *Mail and Guardian Online* (27 September 2011).
[305] See "Parastatals has an important role to play", says Gigaba *Mail and Guardian Online* (27 September 2011).
[306] See the Budget Review 2017 149-151 for a comprehensive breakdown of the planned capital expenditure on infrastructure development by Eskom and Transnet:
(http://www.treasury.gov.za/documents/national%20budget/2017/review/Annexure%20D.pdf)
Eskom, for example, runs various grid projects, which involves the installation of transmission lines, new transformers and upgrading of substations; maintenance projects to enhance the generation, transmission and distribution of electricity. It is also in the process of building a number of new power stations, such as the Medupi and Duvha power stations. Until 2019/2020 Transnet plan to invest significantly in road, rail and ports infrastructure
[307] See the discussion on post- Apartheid SOEs in para 3.4 of this chapter.

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government towards South Africans.[308] Any changes to SOEs such as restructuring, which could include corporatisation or commercialisation and full or partial privatisation of SOEs are therefore highly politicised and controversial. Since it was necessary for the government to adopt an intensified developmental response to the Apartheid legacy, it might be more sceptical of the private sector and its ability to do the "right things" when supplying those products and services which SOEs are currently providing to South Africans even if the private sector is doing "things right" in regard to maximization of profits and producing products efficiently.[309] Labour unions, employees of SOEs and South Africans generally have a deep interest in any planned changes to SOEs and many even object to any changes.[310]

The socio-economic challenges faced by the majority of South Africans make it rather difficult for the government to sit back and to consider minimising its involvement in the economy. When all these challenges in South Africa are considered it becomes clear that the government will not easily part with its ownership or shared ownership of SOEs. This is particularly so for SOEs that operate within sectors which are of strategic importance to all the people of South Africa and its economy. The co-existence of SOEs and their private counterparts in the South African economy will therefore continue for some time to come.

Nevertheless the wide-ranging use of SOEs has also been subjected to trenchant criticism.[311] It has been observed that SOEs place unnecessary burdens on South Africa's public purse and that it puts off foreign direct investment from investors who

[308] A number of SOEs fulfil this role in South Africa.

[309] R Ramamurti "Controlling State-owned Enterprises" in R Ramamurti & R Vernon (eds) *Privatization and Control of State-Owned Enterprises* (1991) 206 207 states that private enterprises "do things right" as they are efficient, quick and innovative but they do not always "do the right things", while governments "do the right things" and use SOEs to achieve the "right things".

[310] Southall states opposition to any changes to SOEs was experienced by both Mandela and Mbeki from within the ANC and COSATU. See R Southall "The ANC, black economic empowerment and state-owned enterprise: a recycling of history? in S Buhlungu, J Daniel, R Southall & J Lutchman (eds) *State of the Nation: South Africa 2007* (2007) 201 207.

[311] Such criticism is reflected in articles such as M Mutize & S Gossel "Corrupt state owned enterprises lie at the heart of South Africa's economic woes" (accessible on https://theconversation.com/corrupt-state-owned-enterprises-lie-at-the-heart-of-south-africas-economic-woes-79135); and SM Muller "South Africa needs to sober up to save itself from sickly state-owned enterprises" (accessible on https://theconversation.com/south-africa-needs-to-sober-up-to-save-itself-from-sickly-state-owned-enterprises-83822).

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may be wary of investing in firms if they have to compete with government-funded SOEs.[312]

It would therefore be foolish to ignore the reality that SOEs in South Africa have not always done the "right things". This is clearly illustrated by the role which SOEs played during the nearly ten years of the Zuma administration. SOEs together with other state institutions such as the South African Revenue Services became synonymous with corruption, patronage, cronyism, nepotism, fraud and allegations of unimaginable amounts of public money being stolen.

The Zuma-era has become synonymous with the concept of "state capture". "State capture" is not a uniquely South African concept. A research project by scholars associated with the World Bank and the European Bank for Reconstruction and Development showed that "state capture" occurs in many countries, especially those in transition.[313] These scholars state that "state capture" refers to the "extent to which firms make illicit and non-transparent private payments to public officials in order to influence the formation of laws, rules, regulations or decrees by state institutions."[314]

In South Africa the term is used to refer to the corrupt relationships which allegedly existed between the former president, some members of his cabinet, other state and provincial officials and the Gupta family. Helen Zille, a South African politician and former leader of the main opposition party, describes "state Capture" as "the practice of powerful politicians turning supposedly independent institutions into political instruments to pursue their own agendas, protecting their allies, prosecuting their

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[312] M Mutize & S Gossel "Corrupt state owned enterprises lie at the heart of South Africa's economic woes" (accessible on https://theconversation.com/corrupt-state-owned-enterprises-lie-at-the-heart-of-south-africas-economic-woes-79135); and SM Muller "South Africa needs to sober up to save itself from sickly state-owned enterprises" (accessible on https://theconversation.com/south-africa-needs-to-sober-up-to-save-itself-from-sickly-state-owned-enterprises-83822).

[313] See JS Hellmann, G Jones & D Kaufmann "Seize the state, seize the day: state capture and influence in transition economies" (2003) 31(4) *Journal of International Comparative Economics* 751 751- 773; and J S Hellman, G Jones, D Kaufmann & M Schankerman *Measuring governance, corruption and state capture. How firms and bureaucrats shape the business environment in transition economies* (2000) http://documents.worldbank.org/curated/en/241911468765617541/pdf/multi-page.pdf.
In regard to "State capture" in South Africa, see for example P-L Myburgh *The Republic of Gupta: A Story of State Capture* (2017); T Gqubule *No Longer Whispering to Power: The Story of Thuli Mandonsela* (2017); and H Zille *Not Without a Fight* (2016).

[314] JS Hellman, G Jones & D Kaufmann "Seize the State, Seize the Day": State Capture, Corruption, and Influence in Transition" Policy Research Working Paper No. 2444 World Bank (2000) 7 (available at https://openknowledge.worldbank.org/handle/10986/19784).

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enemies and enriching themselves."[315] She goes on to say that "State capture is the root cause of failure of democratic transitions across our continent and in many parts of the world."[316]

The now infamous Gupta family arrived in South Africa in the early 1990s. They started some business ventures and eventually established their well-known company, Sahara Computers, in 1997.[317] South Africans probably will never know for sure how long the former president and the Gupta family knew each other and when the alleged corrupt relationship started. There seems to be proof that the relation between the Gupta family and Zuma might have existed[318] long before the South African public became aware of it. Their relationship with the President became headline news when "Waterkloofgate"[319] happened. This refers to the incident in 2013 when the Gupta family was allowed to land a private aeroplane with wedding guests at the Waterkloof Airforce Base in Pretoria, which is described as the South African Airforce's "busiest airbase".[320]

The full extent of the alleged "state Capture" in South Africa was catalogued when Thuli Madonsela, the Public Protector[321] from 2009 until 2016, issued a damning report[322] in October 2016. The report was published after the Public Protector investigated a complaint about alleged improper and unethical conduct by the former president and other state functionaries and their improper relations with members of the Gupta family, who were allegedly involved in the removal and appointment of

[315] H Zille *Not without a Fight* (2016) 331.
[316] H Zille *Not without a Fight* (2016) 331.
[317] P-L Myburgh *The Republic of Gupta: A Story of State Capture* (2017) 22-23.
[318] Myburgh states that Zuma might have met the Guptas already in 1998 but the Guptas themselves claim that they only met Zuma in the early 2000s. See P-L Myburgh *The Republic of Gupta: A Story of State Capture* (2017) 26-27.
[319] P-L Myburgh *The Republic of Gupta: A Story of State Capture* (2017) 115-120.
[320] http://www.saairforce.co.za/the-airforce/bases/5/air-force-base-waterkloof.
[321] The Public Protector is identified by the Constitution of the Republic of South Africa as one of those institutions which is responsible for the strengthening of South Africa's constitutional democracy. In regard to the powers of the Public Protector , the Constitution states as follows: "(1) The Public Protector has the power, as regulated by national legislation-
(a) to investigate any conduct in state affairs, or in the public administration in any sphere of government, that is alleged or suspected to be improper or to result in any impropriety or prejudice;
(b) to report on that conduct; and
(c) to take appropriate remedial action."
Sections 182-183 of the Constitution of the Republic of South Africa of 1996.
[322] State Capture: Report on an investigation into alleged improper and unethical conduct by the President and other state functionaries relating to alleged improper relationships and involvement of the Gupta family in the removal and appointment of Ministers, Directors of State-Owned Enterprises resulting in improper and possibly corrupt award of state contracts and benefits to the Gupta family's businesses, Report No. 6 of 2016/2017.

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ministers and directors of SOEs which resulted in improper and possibly corrupt award of state contracts and benefits to the Gupta family's businesses.[323] Two other reports which contained similar worrying information on the alleged "state capture" followed that of the Public Protector: one by the South African Council of Churches called the "Unburdening Panel Process" and one by an inter-university research group called the "Betrayal of the Promise: How South Africa is being Stolen"[324]

For purpose of this thesis it is particularly important to look at the capture of SOEs in greater detail. These reports implicated South Africa's most significant SOEs. The Public Protector's report in particular scrutinised certain Gupta-links to Transnet, Eskom, Denel, the SABC and SAA.[325] The Public Protector investigated alleged irregularities in the awarding of contracts by all these SOEs to a number of Gupta-owned companies. In regard to Eskom, alleged irregularities in the awarding of contracts by Eskom to Tegeta Exploration and Resources and Optimum Coal Mine, two Gupta-owned companies and the sale of all shares held by Optimum Coal Holdings and mining rights to Tegeta Exploration and Resources were investigated.[326] In regard to the Transnet, contracts awarded by Transnet to Regiments Capital and Trillian, two companies with a Gupta connection were considered.[327] In regard to Denel, contracts concluded between Denel and VR Laser Services, a company owned by the Gupta family were exposed.[328] In regard to SAA a contract awarded by SAA to the New Age newspaper for circulation to its customers was placed under the microscope.[329] In regard to the SABC, contracts awarded to the New Age newspaper and/or TNA Media by the SABC, which are also companies with Gupta-links, were investigated.

Some disturbing facts came to light in regard to those SOEs implicated in the alleged "state capture". These included, inter alia, that in awarding certain contracts to

[323] State Capture: Report on an investigation into alleged improper and unethical conduct by the President and other state functionaries relating to alleged improper relationships and involvement of the Gupta family in the removal and appointment of Ministers, Directors of State-Owned Enterprises resulting in improper and possibly corrupt award of state contracts and benefits to the Gupta family's businesses, Report No. 6 of 2016/2017, http://www.pprotector.org/library/ivestigation_report/2016-17/State_Capture_14October2016.pdf.
[324] (available at https://www.wits.ac.za/media/wits-university/news-and-events/images/documents/Betrayal-of-the-Promise-25052017.pdf).
[325] Para 4.4 of the Public Protector State Capture Report.
[326] Para 4.10 of the Public Protector State Capture Report.
[327] Para 4.15 of the Public Protector State Capture Report.
[328] Para 4. 21 of the Public Protector State Capture Report.
[329] Para 2.25 of the Public Protector State Capture Report.

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Tegeta, the Eskom board was solely acting for the benefit of Tegeta;[330] that certain payments by Eskom to Tegeta may not have been in line with the PFMA;[331] that the Eskom Board did not appear to have complied with their duty of care when dealing with these Gupta-linked companies and this may have constituted a violation of section 50 of the PFMA.[332] These are only a few examples of the many transgressions that formed part of "state capture". Generally it became apparent from the report that for the last decade, instead of delivering on their mandates to South Africans, these SOEs became burdens to the South African people and benefited only the corrupt capturers of the state and their accomplices. It is submitted that by being such a significant part of the alleged "state Capture", SOEs prolonged and amplified the intolerable socio-economic challenges faced by the majority of South Africans.

In light of all her disturbing findings, the Public Protector recommended that Jacob Zuma appoint a commission of inquiry, headed by a judge who had to be solely selected by the Chief Justice of South Africa.[333] She further recommended that the records of her investigations and her report be used as the starting point for the commission of inquiry.[334] As a result of the Public Protectors' remedial action and Zuma's opposition thereto, numerous court cases by opposition parties,[335] civil society organisations and the former president and some of his associates[336] followed. Zuma attempted to have the Public Protector's report judicially reviewed.[337] However, finally in January 2018, long after the release of the Public Protector's report in October 2016 and following numerous attempts to frustrate the process with spurious tactical litigation, Zuma decided to establish a commission of inquiry[338] to investigate the alleged "State Capture". The commission started its hearings in August 2018. At the time of completing this thesis the Commission had not yet

[330] Para 6.2 of the Public Protector State Capture Report.
[331] Para 7.9 (a) of the Public Protector State Capture Report.
[332] Para 7.9 (b) of the Public Protector State Capture Report.
[333] Para 8.4 of the Public Protector State Capture Report.
[334] Para 8.6 of the Public Protector State Capture Report.
[335] *Democratic Alliance v President of the Republic of SA; In re Democratic Alliance v President of the Republic of SA* [2017] 3 All SA 124 (GP); *Economic Freedom Fighters v Speaker of the National Assembly* 2018 (2) SA 571 (CC).
[336] *Molefe v Eskom Holdings Soc Limited* 2017 JDR 1191 (LC).
[337] *President of the Republic of South Africa v Office of the Public Protector 2018 (5) BCLR 609 (GP).*
[338] See Government Gazette No. 41403 Vol. 631 (25 January 2018) for the terms of reference of the Commission of Inquiry.

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completed its work but the hearings have already illustrated how SOEs participated in "state capture" disregarded the broad interests of especially vulnerable and poor South Africans.

Although SOEs will remain a part of economic regulation there may be a need to regulate them adequately to mitigate harm they may cause. However, this should be done after a more detailed analysis of creation and main purpose of certain SOEs before and after the dawn of democracy as well as an evaluation of the role which specific SOEs play today in the South African economy and society.

3 3 An overview of the most significant pre-democracy SOEs[339]

3 3 1 Iscor[340]

Iscor was established in 1928 by the Iron and Steel Industry Act 11 of 1928.[341] It was the largest iron and steel producer in South Africa. Jan Smuts, the Prime Minister at the time, envisaged that state intervention in the iron and steel industry would meet the domestic demand for iron and steel and would create jobs.[342] Consequently Iscor needed some protection against the importation of foreign iron and steel. This was provided through the implementation of dumping duties[343] on foreign steel.[344] The outbreak of World War II was favourable for Iscor.[345] The countries which previously

[339] For purposes of this study the focus of the historical overview will only start with the post-World War period. Any study of SOEs in South Africa before that time is beyond the scope of this study.
[340] Now Mittal Steel SA Ltd and part of the ArcelorMittal Group of Companies.
[341] CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 120. See also H Giliomee *The Afrikaners: Biography of a People* (2003) 341.
[342] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 59. See also www.arcelormittalsa.com for a short history on ISCOR.
[343] See RM Bolton "Anti-Dumping and Distrust: Reducing Anti-Dumping Duties under the W.T.O. Through Heightened Scrutiny" (2011) 29(1) *Berkeley Journal of International Law* 66 70 for further reading on anti-dumping and why it is justified by the World Trade Organization. He said that "the anti-dumping provisions in the W.T.O. … allow members to impose duties whenever they believe that exports have been "dumped" into their country in violation of Article VI and the Agreement on Implementation of Article VI (known as the Anti-Dumping Agreement, or A.D.A.). These agreements allow protection whenever an export is sold at "less than normal value" as determined by the importer's domestic government." The WTO's predecessor which regulated such trade barriers is the General Agreement on Tariffs and Trade (GATT). The WTO's anti-dumping measures came from the provisions of its predecessor. Bolton observes that "The anti-dumping regime was an important factor in establishing the original General Agreement on Tariffs and Trade (G.A.T.T.) framework and most (if not all) governments would reject a proposal that completely excised the anti-dumping "safety-valve" from the W.T.O."
[344] WG Martin *South Africa and the World Economy: Remaking Race, State, and Region* (2013) 93.
[345] WG Martin *South Africa and the World Economy: Remaking Race, State, and Region* (2013) 94.

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exported iron and steel to South Africa, such as Britain, Germany and the United States, relied on the output of their industries to see them through the war. Those in South Africa who relied on imported iron and steel, could now only get it from Iscor. Iscor was credited with setting the pace for industrialisation in South Africa.[346] Martin states that Iscor allowed South Africa to join the "privileged ranks" of countries which had steelworks[347] and that:

> "The ISCOR case stands as the crowning achievement of state intervention in the interwar period, a bold new entry by the state into the realm of what had hitherto been the privileged realm of private capital accumulation."[348]

In 1989 the South African government promulgated the Conversion of Iscor Limited Act 57 of 1989 (the Conversion Act). The Conversion Act, inter alia, provides for the conversion of Iscor into a company in terms of the Companies Act 61 of 1973 and for the disposal by the State of shares held in the company.[349] Section 6 of the Conversion Act deals with the shareholding of the State and the disposal of its shares in the converted enterprise. The section authorised the Minister of Administration and Privatisation in conjunction with the Minister of Finance to dispose of shares held by the state to any person and in any manner they deemed fit. After various investigations on the viability of selling Iscor, the government sold Iscor in 1989 for R3.7 billion.[350] The Competition Tribunal of South Africa said in 2007 that:

> "Iscor was selected to lead the then South African government's privatisation programme, ushering in a new era in the company's history with its listing on the Johannesburg Securities Exchange ("JSE") on 8 November 1989."[351]

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[346] WG Martin *South Africa and the World Economy: Remaking Race, State, and Region* (2013) 92.
[347] WG Martin *South Africa and the World Economy: Remaking Race, State, and Region* (2013) 93.
[348] WG Martin *South Africa and the World Economy: Remaking Race, State, and Region* (2013) 95.
[349] See the Preamble of the Conversion of Iscor Limited Act 57 of 1989.
[350] SA Mohammed (Secretary-General of the African Iron and Steel Association), "Privatisation of the Iron and Steel Industry in Africa" Paper presented at the 8th International Arab Iron and Steel Conference held at Doha, Qatar 17th- 19th March 2008 2-3. For further reading on the privatisation of Iscor see J Aron, B Kahn & G Kingdon "South African Economic Policy under Democracy" in J Aron, B Kahn & G Kingdon (eds) *South African Economic Policy under Democracy* (2009) 1 5.
[351] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.

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In March 2001 Iscor announced its restructuring and this process was completed in November 2001, with the listing of Kumba on the Johannesburg Securities Exchange.[352] Kumba is the company which obtained Iscor's mining assets while Iscor remained a pure steel company.[353] At the end of 2003, another world leading steel producer, LNM Holdings B.V. gained control over Iscor.[354] This was achieved through the acquisition of a 50 percent shareholding in Iscor, after it started off with an initial 34, 8 percent shareholding.[355] Hereafter Iscor changed its name to Ispat Iscor and then to Mittal Steel SA.[356] When Mittal Steel, a multinational corporation, and Arcelor, the world's second largest steel producer at the time, merged in 2006,[357] the merged company became known as Arcelor Mittal and Mittal Steel SA came under the control of Arcelor Mittal.[358] Today, the now renamed Iscor forms part of the ArcelorMittal group, the world leading steel producer, with ArcelorMittal South Africa Limited being the largest steel producer in South Africa that manufactures half of Africa's steel.[359]

3 3 2 ESCOM/Eskom

ESCOM was established by the Electricity Act of 1922. Christie argues that the difficulty which the South African Railways (SAR) experienced in transporting coal from Natal played an important role in the establishment of ESCOM. This was because the electrification of SAR locomotives would have been more beneficial for it as they would be more powerful and less labour would be required.[360] The SAR explored options such as its own power stations, supply of electricity by municipalities and buying electricity from a private enterprise but all these options

[352] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.
[353] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.
[354] The merger between LNM Holdings NV and Iscor Limited was approved by the Competition Tribunal in *LNM Holdings N V / Iscor Ltd* [2004] 2 CPLR 311 (CT). See in this regard also *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.
[355] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.
[356] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.
[357] See *Mittal Steel Company N.V. and Arcelor SA* 53/LM/Jun06.
[358] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) 40.
[359] https://www.arcelormittalsa.com/thinksteel/index.php/steel/steel-for-africa/.
[360] R Christie *Electricity, Industry and Class in South Africa* (1984) 75.

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were unattractive.[361] Therefore the SAR was in favour of the establishment of a state-owned enterprise for the supply of electricity.[362] William Hoy, the general manager of the SAR wanted the state to have a significant role in the production of electricity.[363] Jan Smuts, the Prime Minister of South Africa at the time, showed his willingness for state intervention with regard to electricity supply if this would assist South Africa in its ambition to industrialise.[364] Those tasked[365] by Smuts to investigate such state intervention in the electricity supply industry indicated that it would be beneficial for any industrialisation ideals.[366] This was the start of a process that would end in the establishment of ESCOM.[367] Hendrik van der Bijl became ESCOM's first chairman. As he was also the chairman of Iscor, he "led the creation of South Africa as a modern industrial state."[368]

In 1987 ESCOM (Afrikaans Evkom) was renamed as Eskom by the Eskom Act No. 40 of 1987 (Eskom Act). Section 2 (1) of the Eskom Act provided as follows:

> "The juristic person established under section 1 read with section 2 of the Electricity Act, 1922 (Act No. 42 of 1922), and known as the Electricity Supply Commission, which continued to exist as a juristic person known as Escom under section 2 of the Electricity Act, 1958 (Act No. 40 of 1958), shall continue to exist as a juristic person known as Eskom notwithstanding the repeal of the latter Act by section 31 of the Electricity Act, 1987."

The Eskom Act was repealed by the Eskom Conversion Act No. 13 of 2001, which converted Eskom into a public company having a share capital, with its entire share

[361] R Christie *Electricity, Industry and Class in South Africa* (1984) 75-76 for these reasons.
[362] R Christie *Electricity, Industry and Class in South Africa* (1984) 76.
[363] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 51.
[364] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 49.
[365] Clark states that an overseas consulting firm, Merz and McMellan was tasked by Smuts to investigate the viability of state intervention in the electricity supply industry. See NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 49.
[366] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 49.
[367] See CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 120. See www.eskom.co.za for a complete summary on ESKOM's heritage and the establishment of various power stations.
[368] R Christie *Electricity, Industry and Class in South Africa* (1984) 77.

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capital held by the South African government.[369] Today Eskom is the world's eleventh largest electricity producer. It produces, transports and distributes about ninety five percent of South Africa's and about forty five percent of Africa's electricity.[370] However, in recent years Eskom has been plagued by various difficulties. It has been party to many legal matters which involved various disciplines of the law such as administrative law, delict, competition law, constitutional law, company law and labour law.

More recent troubles faced by Eskom were poor corporate governance, severe corruption within the SOE[371] and its inability to supply South Africa with electricity. As the demand for electricity in South Africa rose, Eskom's capacity failed to keep up. South Africans faced regular loadshedding[372] for prolonged periods. The most vulnerable people in South Africa, those who the government wants to protect by providing affordable electricity through Eskom and those who are supposed to enjoy the benefits of the government's developmental goals, were the ones that suffered most, due to Eskom's incapacity to supply electricity on demand. They are the ones who rely fully on Eskom for electricity supply and are also unable to afford alternative electricity generators. Major loadshedding at present and the consequences of prolonged corruption, poor corporate governance and financial maladministration in Eskom during the Zuma era undoubtedly impact on the government's ability to achieve its goal of supplying affordable electricity to all South Africans. Therefore drastic steps had to be taken when Cyril Ramaphosa became the president of South Africa. In his first State of the Nation Address in February 2019, President Ramaphosa announced that Eskom will be restructured in three separate entities: generation, transmission and distribution. He said: "It is imperative that we undertake these measures without delay to stabilise Eskom's finances, ensure security of electricity supply, and establish the basis for long-term sustainability." It remains to be seen whether this intervention by the government will lead to improvements in regard to Eskom's operations, management and delivering of its governmental

[369] Section 2 of the Eskom Conversion Act.
[370] See http://www.dpe.gov.za/ and www.eskom.co.za (accessed on 10 February 2015).
[371] See the discussion on "State capture" in para 3.2 of this chapter.
[372] As the word suggest, Eskom sheds some load from the national grid by making electricity unavailable in areas all over South Africa for a certain time of the day. A timetable is drawn up which determine when areas will be shed of the off the national grid.

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mandate. The Goldman Sachs Group describes Eskom as South Africa's "biggest financial risk".[373] Hence, the success of Eskom during the unbundling and thereafter is crucial in light of the severe risk which Eskom's potential failure poses to the South African economy. The economic prospects of South Africa as a country are thus dependent on Eskom's success and for the sake of all South Africans, Eskom's operations, finances, management and corporate governance need to be sorted out urgently.

3 3 3 The IDC

The IDC was established in 1940 by the Industrial Development Corporation Act 22 of 1940 "to promote the development of local industries".[374] The purpose of the Act was to "constitute a corporation the object of which shall be to promote the establishment of new industries and industrial undertakings and the development of existing industries and industrial undertakings."[375] Clark notes that when there was no interest from private investors in an industry, the IDC could establish an undertaking on its own as was the case in the wool industry.[376] According to its founding legislation, the IDC aims, inter alia, to establish and conduct industrial undertakings, to facilitate, promote, guide and assist in the financing of new industries and industrial, schemes for the expansion, better organization and modernization of and the more efficient carrying out of operations in existing industries and industrial, or ancillary or related economic, undertakings and to promote the economic empowerment of the historically disadvantaged communities and persons.[377] Feinstein argues that the IDC was operated like an industrial bank and that state intervention in the economy was maintained through the IDC.[378] Feinstein is further of the opinion that the IDC was used by the government in the Apartheid years to "strengthen the economic position of Afrikaner firms".[379] Furthermore, industries established by the IDC "were to have a monopoly of

[373] https://www.washingtonpost.com/business/energy/why-eskoms-power-crisis-is-south-africas-top-risk/2019/12/11/f963b48c-1bfa-11ea-977a-15a6710ed6da_story.html. (accessed on 12 December 2019).
[374] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 108.
[375] See the Preamble of the Act.
[376] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 160.
[377] See section 3 of the Industrial Development Corporation Act 22 of 1940 for all the aims of the IDC.
[378] CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 183.
[379] CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 179.

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production and supply within South Africa, with their sole competition coming from imports".[380]

During the state sector expansion from 1948 many new SOEs were established under the auspices of the IDC while others were expanded.[381] These included, inter alia, the Phosphate Development Corporation in 1952 to produce phosphate for the agricultural sector in South Africa,[382] Sasol in 1950 to produce oil from coal[383] and the Armaments Corporation of South Africa (Armscor) in 1968, which manufactured armaments for the government after an embargo imposed by the United Nations on South Africa in regard to the sale of arms.[384] The South African Railways and Harbours and Escom are some examples of SOEs which were expanded.[385]

Today the IDC is still maintaining the mandate for which it was established and this mandate was expanded to include industrial development in the rest of Africa.[386]

3 3 4 Sasol

Sasol was established in 1950 by the IDC,[387] when the government started to explore the possibility of establishing a coal-to-oil producer after private ventures failed due to a lack of funding.[388] Clark argues that the establishment of Sasol by the government was a direct result of the "failure of private capital to do so".[389] The creation of Sasol was celebrated as "the birth of a strategically important enterprise

[380] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 130.
[381] S Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 203.
[382] See www.foskor.co.za for a detailed historical overview of FOSKOR. See also S Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 203.
[383] S Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 203. See also CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 183.
[384] CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 184.
[385] S Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 203.
[386] See http://www.idc.co.za for the IDC's mandate.
[387] See JJ Wakeford *Preparing for Peak Oil in South Africa: An Integrated Case Study* (2013) 13 for a historical timeline of South Africa's petroleum industry. See also *Sasol Ltd / Engen Ltd* [2006] 1 CPLR 189 (CT) 208 for a short overview on the establishment of Sasol.
[388] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 161.
[389] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) 161.

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'not controlled from abroad or by international monopolies and cartels but by the South African state'".[390] Hence, Sasol is described as South Africa's "coal-to-oil project" which was "central to apartheid South Africa's response to oil sanctions"[391]

Although there were initial regrets about the establishment of Sasol due to the rise in "capital requirements",[392] various plants were established which were operated by Sasol and these plants provided some of South Africa's much needed oil.[393] Further investment in and expansion of Sasol was driven by the urgent need to ensure supplies despite: (i) the international oil crisis of 1973; (ii) a United Nations imposed oil embargo in 1977, which was implemented by many oil-exporting countries,[394] and (iii) the Revolution in 1979 in Iran which at that point was one of the major oil suppliers to the country.[395] Sparks[396] argues that it was the state's intervention to: (i) regulate the fuel market, (ii) discipline the oil multinationals, and (iii) massively subsidise the oil-from-coal project that was decisive to Sasol's viability.[397] Added to that, was the diversification of Sasol's operations. When oil prices were low during the 1960s, Sasol expanded its operations by venturing into the chemical industry with state support.[398]

In 1979 Sasol was privatised and became Sasol Limited. Sparks states that the first step to privatisation came about when two new oil-from-coal plants, Sasol 2 and 3 which started operations in 1982, had to be funded during difficult economic conditions following the oil shock of 1973.[399] Sparks further notes that the public

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[390] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" 42(4) 2016 *Journal of Southern African Studies* 711 715.
[391] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 712.
[392] NL Clark *State Corporations in South Africa, Manufacturing Apartheid* (1994) 162 where then-Minister of Finance, NC Havenga is quoted expressing his concerns over Sasol's capital requirements.
[393] B River & M Bailey "How Oil Seeps into South Africa" (1981) 81(39) *Business and Society Review* 53 54-55.
[394] B River & M Bailey "How Oil Seeps into South Africa" (1981) 81(39) *Business and Society Review* 53 53.
[395] *Sasol Ltd / Engen Ltd* [2006] 1 CPLR 189 (CT) 209.
[396] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 712.
[397] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 713.
[398] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 713.
[399] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 721.

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purse could not carry the cost of the two new plants and therefore private investment was needed to supplement the fuel levy and the loans from the IDC.[400] Even after being listed on the Johannesburg Stock Exchange, Sasol continued to enjoy "special strategic status" since the state continued to subsidise it via fuel levies.[401] Most of the state support was only completely removed after the end of Apartheid.[402]

Today Sasol is a successful multinational corporation with operations in various countries. It is listed on both the Johannesburg Securities Exchange and the New York Stock Exchange. Sasol is a leading producer of chemicals, liquid fuel from coal and natural gas and it is involved in large "gas-to-liquid schemes" in various countries such as China and the United States.[403]

3 3 5 Armscor

In 1963 the United Nations (UN) imposed an embargo on the sales of arms to South Africa.[404] The embargo called upon all states "to cease forthwith the sale and shipment of arms, ammunition of all types and military vehicles to South Africa"[405] Previously South Africa imported most of its armament from the United Kingdom.[406] Armscor was established by the Armament Development and Production Act 57 of 1968[407] as a direct result of the UN arms embargo. It had to ensure that the government had sufficient armaments[408] and provided both the military and police

[400] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 721.
[401] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 723.
[402] S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" 42(4) 2016 *Journal of Southern African Studies* 711 723.
[403] J Daniel, J Lutchman & A Comninos "South Africa in Africa: trends and forecasts in a changing African political economy" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 508 523.
[404] See the United Nations Security Council Resolution on Arms Embargo Against South Africa Resolution 282 (1970) which was adopted by the Security Council at its 1549th meeting on 23 July 1970 in (1970) 9(5) *International Legal Materials* 1091 1091-1092. The embargo was only terminated in May 1994. See the United Nations Security Council Resolution 919 (1994) Concerning the Termination of the Arms Embargo against South Africa of 25 May 1994 in (1994) 33(4) *International Legal Materials* 1060 1060-1061.
[405] Para 3 of Resolution 181 (1963) of 7 August 1963 (available at http://repository.un.org/bitstream/handle/11176/80893/S_RES_181%281963%29 EN.pdf).
[406] CM Rogerson "Defending Apartheid: Armscor and the Geography of Military Production in South Africa" (1990) 22(3) *GeoJournal* 241 242.
[407] This Act has now been repealed by the Armaments Corporation of South Africa Limited Act 51 of 2003.
[408] CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 184.

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with a modern arsenal.[409] Armscor was therefore created to reduce South Africa's dependence on foreign military supplies[410] and transformed South Africa from an importing country in regard to armaments to an arms producing country.[411] Armscor did not constitute the first attempt to manufacture arms in South Africa. Rogersons argues, that South Africa's "military industrialization" was already well on its way at the time of the embargo.[412] But Armscor escalated the manufacture of arms against the backdrop of the embargo. Armscor played an important role in "protecting the apartheid government" and helped the government in 1976 to control uprisings in Soweto with locally manufactured weapons.[413]

Today Armscor remains a state-owned enterprise and the Armaments Corporation of South Africa Limited Act 51 of 2003 provides for its continued existence. The state remains the sole shareholder of the enterprise.[414] Armscor's current objectives include:

> "to meet—
> (a) the defence matériel requirements of the Department effectively, efficiently and economically; and
> (b) the defence technology, research, development, analysis, test and evaluation requirements of the Department effectively, efficiently and economically."[415]

After 1994 the government decided to reduce the defence budget since it had to focus on other pressing issues such as the eradication of poverty. As a result Armscor started to produce civilian products alongside its military armaments products.[416] Since the production of civilian products was prohibited by the Act which established Armscor, it was split into two enterprises, one of which is today known as

[409] RB Beck *The History of South Africa* (2013) 141.
[410] RB Beck *The History of South Africa* (2013) 141.
[411] CM Rogerson "Defending Apartheid: Armscor and the Geography of Military Production in South Africa" (1990) 22(3) *GeoJournal* 241 243.
[412] CM Rogerson "Defending Apartheid: Armscor and the Geography of Military Production in South Africa" (1990) 22(3) *GeoJournal* 241 243.
[413] NL Clark *State Corporations in South Africa: Manufacturing Apartheid* (1994) xi.
[414] Section 2 of the Armaments Corporation of South Africa Limited Act 51 of 2003.
[415] Section 3 of the Armaments Corporation of South Africa Limited Act 51 of 2003.
[416] See www.armscor.co.za for a historical overview on Armscor. (accessed on 12 February 2015).

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Denel (Pty) Limited,[417] the "largest manufacturer of defence equipment in South Africa" with the South African government as its sole shareholder.[418]

3 3 6 Concluding Remarks

The above mentioned SOEs are only a selected sample of the SOEs that contributed to South Africa's industrialization before and after World War II. Feinstein observes that economic difficulties and the "economic cost of apartheid ideology and practice" made a continuation of such policies ever more difficult for the government.[419] Economic hardship led the government to consider reforms. Hill argues that the appointment of the Wiehann and Rieckert Commissions represented "the most important outward and visible signs of the new climate of thinking among the Afrikaner elite".[420] The Wiehann Commission was tasked to review the labour legislation and to make recommendations on how to reform it.[421] The Rieckert Commission under the stewardship of PJ Rieckert, the Economic Advisor to the Prime Minister at the time and the Chairman of the Prime Minister's Economic Advisory Council, was task to review a wide range of legislation.[422] The various reforms recommended by these two commissions in their reports were hailed as "major developments that would bring fundamental changes in South Africa for the Black population".[423] Recommendations in these two reports led to the start of the gradual dismantling of the policies in place at the time, with their final elimination in 1994 when South Africa had its first democratic elections. This was when the new ANC government inherited more than 300 SOEs in various sectors, from the Apartheid government, with the significant ones being Transnet, Telkom and Eskom.[424]

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[417] See www.armscor.co.za where this split between Denel and Armscor is explained.
[418] See http://www.dpe.gov.za/soc/Pages/Denel.aspx (accessed on 12 February 2015).
[419] CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 240.
[420] CR Hill Change in South Africa: Blind Alleys or New Direction (1983) 97. See also CH Feinstein *An Economic History of South Africa: Conquest, Discrimination and Development* (2005) 241.
[421] CR Hill Change in South Africa: Blind Alleys or New Direction (1983) 97.
[422] CR Hill Change in South Africa: Blind Alleys or New Direction (1983) 97.
[423] WJ Vose "Wiehann and Rieckert Revisited: A Review of Prevailing Black Labour Conditions in South Africa" (1985) 124(4) *International Labour Review* 447 451.
[424] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 206.

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3 4 SOEs in the democratic dispensation[425]

Today the number of SOEs which operate as part of South Africa's economy remains large. The influence of SOEs remains significant in many key sectors of the economy. South Africa thus continues to have a mixed economy with both private enterprises and SOEs. Schedule two and three of the PFMA list both national and provincial SOEs as well as municipal SOEs. Examples include enterprises such as the Airports Company, Denel, Eskom, the SABC, SA Express, SA Forestry Company Limited, SAA and Telkom SA Limited.[426] The number of SOEs listed in the schedules to the PFMA provides a clear picture on the active role which the state still plays in the economy. State intervention in the economy has thus not been down-scaled in the democratic era. This was to be expected considering the enormous socio-economic challenges which the post-Apartheid governments have to address and the ideological impetus that is provided by the Freedom Charter.[427] The Freedom Charter states that:

"The People Shall Share in the Country`s Wealth!

> The national wealth of our country, the heritage of South Africans, shall be restored to the people;
>
> The mineral wealth beneath the soil, the Banks and monopoly industry shall be transferred to the ownership of the people as a whole;
>
> All other industry and trade shall be controlled to assist the wellbeing of the people;"

From these words it is clear that nationalization or at least strong resistance to privatization would be firmly embedded within the future policies of the ANC. It also made clear that certain sectors of the economy were inevitably going to be

[425] See in this regard also para 3 2 of this chapter for the discussion on the ANC-led government's decisions whether to retain or divest the SOEs inherited from the Apartheid government.
[426] See Schedule two and three of the PFMA for a complete list of SOEs.
[427] The Freedom Charter was adopted in June 1955 by the Congress of the People, which consisted of the African National Congress, South African Indian Congress, the South African Coloured People's Organisation and the South African Congress of Democrats. See *ANC v COPE* [2009] JOL 22935 (T), para 6. It was a statement of all the principles and values, which the ANC and its allies felt South Africa should be governed by. Some of these principles, such as the principle on equal human rights for all South Africans, today from part of South Africa's Constitution.

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nationalized or kept nationalized if inherited from the Apartheid government. Nelson Mandela confirmed this in February 1990, four years before he became president, when he said:

> "Where do we get the capital for the improvement of the living conditions of people if we do not nationalize?"[428]

> "The only way we can raise the resources for development is to nationalise certain sectors of the economy." [429]

Mandela's mind regarding nationalization was however changed by the business community and international institutions such as the International Monetary Fund (IMF). He later concluded that nationalization is not the best option to achieve the goals of the government,[430] but the ANC-led government wanted to ensure that, through its involvement in the economy, it could address the socio-economic challenges.

After Mandela became convinced that privatization is the better option to ensure a growing South African economy which will be attractive to foreign investors, he and Thabo Mbeki, the deputy-president at the time, worked towards an ANC policy which would be more in line with privatization.[431] In 1996 the ANC formulated its "guiding economic policy" for South Africa, which became known as the Growth, Employment and Redistribution Policy (GEAR).[432] Privatisation as a measure to achieve the government's goals of economic development for all, formed part of the government's GEAR policies.[433] It was referred to though as the "restructuring" of

[428] N Mandela *Nelson Mandela By Himself: The Authorised Book of Quotations* (2011) 245.
[429] N Mandela *Nelson Mandela By Himself: The Authorised Book of Quotations* (2011) 246.
[430] N Mandela *Nelson Mandela By Himself: The Authorised Book of Quotations* (2011) 247.
[431] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 207.
[432] A Pitcher "Was privatisation necessary and did it work? The case of South Africa" (2012) 39(132) *Review of African Political Economy* 243 244.
[433] D Goodman *Fault Lines: Journey into the new South Africa* (1999) 226 and the Growth, Employment and Redistribution Macroeconomic Strategy (GEAR)
(available at http://www.treasury.gov.za/publications/other/gear/chapters.pdf) (accessed on 5 January 2015).

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state assets and not privatization. This was done to appease the unions[434] since the unions feared that privatization would lead to job losses and would compromise the delivery of high-quality and affordable delivery of service to all.[435] They referred to privatization as a "war on the poor".[436] Nonetheless, in 1997 the government started to divest some state assets by selling six radio stations[437] previously owned by the SABC while Telkom and SAA were partially privatized (SAA was later renationalized when the 20% that was sold off was reacquired).[438] All those SOEs which were considered not to be part of a strategically important sector and those which were not necessarily required for assisting in the government's developmental plans were considered for partial or full privatization.[439] By 2003 the government had sold about nine percent of SOEs.[440]

3 5 The Big U-turn on privatization

Thabo Mbeki became the second democratically elected president of South Africa and he continued to be supportive of privatization as part of the economic policy. The government's policy regarding SOEs and privatization under Mbeki has been referred to as a four-way approach.[441] In accordance with this, "non-core" SOEs qualified for full privatization, SOEs that were "strategically important, such as Telkom and Transnet, were to be restructured and only partially sold in the interest of competition and efficiency, SOEs operating within the ports and railways sector were

[434] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 207.
[435] E Harsch "Privatization shifts gears in Africa: More concern for public acceptance and development impact but problems remain" (2000) 14(1) *Africa Recovery* 8 8; and R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 208.
[436] D Goodman *Fault Lines: Journey into the new South Africa* (1999) 226.
[437] OC Iheduru "Black economic power and nation-building in post-apartheid South Africa" (2004) 42(1) *Journal of Modern African Studies* 1 11.
[438] A Pitcher "Was privatisation necessary and did it work? The case of South Africa" (2012) 39(132) *Review of African Political Economy* 243 245. See also R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 208. For more on SAA's renationalization see WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 127.
[439] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation: South Africa 2007* (2007) 201 207.
[440] A Pitcher "Was privatisation necessary and did it work? The case of South Africa" (2012) 39(132) *Review of African Political Economy* 243 245.
[441] WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 129.

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to be run by "concessions" and there would be a formation of public-private partnership to deliver other essential service, especially on municipal level.[442] Mbeki had the intention to privatize many SOEs such as the South African Forestry Company, SAA, Denel and parts of Eskom. Such privatizations however never materialized.[443] National strikes by the Congress of South African Trade Unions (COSATU) against privatization contributed to the Mbeki administration's change of heart.[444] COSATU justified their strikes by referring to the high cost of basic services, rising unemployment and the outsourcing of services by partially privatized enterprises. Other reasons for the change were the conflicts between various governmental institutions over the restructuring of SOEs,[445] employment creation and maintenance, the provision of public goods and black empowerment.[446]

During Mbeki's second administration it was admitted that the performance of SOEs was not satisfactory but that SOEs represented "hugely strategic resources" and with a good restructuring plan SOEs could lead the way on growth and development in South Africa.[447] The focus in South Africa thus shifted from privatization to the restructuring of SOEs in order to make them more efficient and effective and less dependent on government funds.[448] This shift may have been influenced by a study in the United States which found that making SOEs "less dependent on government funding, increasing their efficiency and compelling them to compete with private companies could improve their performance as much as selling them off to private investors".[449] This is in line with what Hentz called "the process of deregulating and commercialising public sector organisations", rather than the selling and transfer of

[442] WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 129.
[443] RHK. Vietor *How Countries Compete: Strategy, Structure, and Government in the Global Economy* (2007) 142.
[444] RHK Vietor *How Countries Compete: Strategy, Structure, and Government in the Global Economy* (2007) 142. See also WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 127.
[445] RHK Vietor *How Countries Compete: Strategy, Structure, and Government in the Global Economy* (2007) 142. See also WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 127.
[446] A Pitcher "Was privatisation necessary and did it work? The case of South Africa" (2012) 39(132) *Review of African Political Economy* 243 249.
[447] R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" in S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 210.
[448] WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 132.
[449] WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 132.

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state assets.[450] It is said that the new strategy adopted in 2004 by the Mbeki administration included new appointments in key positions within SOEs as SOEs were meant to be "in the driving seat to uplift economic growth levels and deliver social and infrastructural services".[451]

However, in September 2008 Mbeki announced his resignation on national television as he had been recalled as President of South Africa by the ANC after he was defeated by the Jacob Zuma in December 2007 to become the President of the ANC at the ANC's national conference in Polokwane in the Limpopo Province.[452] Jacob Zuma became South Africa's president in 2009. Soon thereafter the nationalization rhetoric within the ANC flared up again. The then ANC Youth League leader, Julius Malema announced that it was ANC policy for the South African mines to become nationalized.[453] This was not denied or confirmed by the Zuma administration but was however dismissed by some members of his cabinet such as the Minister of Mines at the time, Susan Shabangu and the then Deputy-President, Kgalema Mothlante.[454] However in September 2010 an investigative team was appointed by the ANC to determine the "desirability" of the nationalization of the mines, banks and manufacturing.[455] The results of the "desirability" investigation were never made known to the South African public but Jacob Zuma did not nationalize private enterprises, as expected by the business community.[456] However, political climate had turned against privatization.

For its 53rd national conference in 2012 the ANC drafted a policy document on the position of SOEs and development finance institutions.[457] This policy document

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[450] JJ Hentz "The two faces of privatisation: political and economic logics in transitional South Africa" (2000) 38(2) *Journal of Modern African Studies* 203 204.
[451] WM Gumede *Thabo Mbeki and the Battle for the Soul of the ANC* (2007) 131.
See also R Southall "The ANC, black economic empowerment and state-owned enterprises: a recycling of history?" S Buhlungu, J Daniel, R Southall & J Lutchmann (eds) *State of the Nation, South Africa 2007* (2007) 201 217.
[452] J Hamill "'Not with a Bang but with a Whimper': The Fall of Thabo Mbeki" (2008) 290(1691) *Contemporary Review* 409 409. For further reading see D Pillay "COSATU, the SACP and the ANC post Polokwane: Looking Left but does it Feel Right?" (2008) 41(2) *Labour, Capital and Society* 4 19-21.
[453] "Support For Zuma is Waning" (2010) 15(12) *Africa Monitor: Southern Africa* 1 2.
[454] "Support For Zuma is Waning" (2010) 15(12) *Africa Monitor: Southern Africa* 1 2.
[455] "Suddenly the nationalisation talk gets serious" (2011) 5(17) *Africa Confidential* 8 9.
[456] KD Guha "Jacob Zuma: Assessing his first three years" (2013) 34(3) *Harvard International Review* 6 6-7.
[457] African National Congress *Economic Transformation: Policy Discussion Paper on State Owned Entities and Development Finance Institutions* (January 2012) 2
(accessible at http://www.anc.org.za/docs/discus/2012/economym.pdf).

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emphasised the role of SOEs "as instruments for significantly advancing the levels of economic transformation within South Africa."[458] In the policy document the ANC stated that SOEs are not created to maximize profits but to assist the state in reaching its developmental goals.[459] It also became clear from the ANC's Strategy and Tactics Policy of 2012[460] that the ANC had no plans to abandon the role of SOEs in the economy and that it will keep South Africa a mixed economy for as long as necessity requires.[461]

3 6 Measures taken to promote corporate governance of SOEs in especially the PFMA[462]

> "Parastatals' are deeply implicated in most fiscal problems of African governments because of their inefficiency, losses, budgetary burdens, and provision of poor products and services. Occasionally, they achieve some non-commercial objectives, which are used to justify their poor economic performance."[463]

With the above statement Mwaura reflects on the position in many African countries and this observation is particularly apposite for South Africa. It is known that proper corporate governance of enterprises leads to efficient and effective enterprises. It may also ensure that SOEs stay financially viable. Much has been written about the corporate governance of SOEs and how to make the management of SOEs more

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[458] African National Congress *Economic Transformation: Policy Discussion Paper on State Owned Entities and Development Finance Institutions* (January 2012) 2
(accessible at http://www.anc.org.za/docs/discus/2012/economym.pdf).

[459] African National Congress *Economic Transformation: Policy Discussion Paper on State Owned Entities and Development Finance Institutions* (January 2012) 4
(accessible at http://www.anc.org.za/docs/discus/2012/economym.pdf).

[460] See the ANC's Policy Document *Strategy and Tactics of the ANC 2012* 27
(available at http://www.anc.org.za/list.php?t=Policy%20Documents -accessed on 17 February 2015)
In it the ANC declares that:
"48.A thriving economy in a national democratic society requires as efficient a market as possible,[…] It will also require a state able to use its capacities to direct national development through […] utilisation of State-owned Enterprises and effective regulation.
49. A national democratic society will have a mixed economy, with state, co-operative and other forms of social ownership, and private capital.[…]" See *"Strategy and Tactics of the ANC 2012* 27 (available at http://www.anc.org.za/list.php?t=Policy%20Documents -accessed on 17 February 2015).

[461] See also the discussion in para 3.2 of this chapter.

[462] See also the discussion on the PFMA in paras 1.2 and 3.2.2 of chapter 5.

[463] K Mwaura "Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya" (2007) 31(1) *Fordham International Law Journal* 34 34.

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"effective and efficient".[464] Sokol states that good corporate governance may provide firms with an edge over competitor firms and improve corporate performance.[465] He further argues that good corporate governance could lead to efficient outcomes in regard to SOEs.[466]

The OECD takes a leading role in researching and proposing measures for promoting corporate governance in SOEs. It attempts to promote effective governance of SOEs within its member states. It is submitted that successful corporate governance measures in the OECD should be considered in non-OECD countries. In 2011 the OECD published the results of interviews it conducted with the Chairs and other board members of SOEs in OECD member states.[467] A key matter which was affirmed by the interviews was that most countries aim is to improve the performance of SOEs and that one way of doing so is to reform the boards of the SOEs.[468] The OECD reports recognise certain factors which could lead to success when governments attempt to enhance the functioning of SOE board. These include, inter alia, that government must clearly communicate policies and objectives to the SOEs, abstain from ad-hoc interventions in the affairs of the SOE once its objectives have been clearly defined, provide training programmes for the boards and the government representatives and provide enhanced communication channels between the CEOs, the boards and the government representative.[469]

The governance of SOEs in South Africa has been under the spotlight on various occasions.[470] The debacles around the chief executive officers of ESKOM[471] and

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[464] See The World Bank *Corporate governance of state-owned enterprises: a toolkit* (2014); OECD *Corporate governance of state-owned enterprises: a survey of OECD countries* (2005); and OECD *Corporate governance of state-owned enterprises: change and reform in OECD countries since 2005* (2011).
[465] DD Sokol "Competition Policy and Comparative Corporate Governance of State-Owned Enterprises" (2009) 6 *Brigham Young University Law Review* 1713 1717.
[466] DD Sokol "Competition Policy and Comparative Corporate Governance of State-Owned Enterprises" (2009) 6 *Brigham Young University Law Review* 1713 1718.
[467] See W Frederick *Enhancing the Role of the Boards of Directors of State-Owned Enterprises OECD Corporate Governance Working Papers No 2* (2011)
(available at http://dx.doi.org/10.1787/5kg9xfg6n4wj-en).
[468] W Frederick *Enhancing the Role of the Boards of Directors of State-Owned Enterprises OECD Corporate Governance Working Papers No 2* (2011) 3
(available at http://dx.doi.org/10.1787/5kg9xfg6n4wj-en).
[469] W Frederick *Enhancing the Role of the Boards of Directors of State-Owned Enterprises OECD Corporate Governance Working Papers No 2* (2011) 3
(available at http://dx.doi.org/10.1787/5kg9xfg6n4wj-en).
[470] Already in 2010 after the State of the Nation Address by President Jacob Zuma, the leader of the then-Independent Democrats, Patricia de Lille, pointed out the President's neglect to address the management of

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Transnet[472] and the legal action taken for the recovery of money from former SAA[473] chief executive officer, Khaya Ngqula, contributed to the belief that the inefficient governance of SOEs in South Africa ultimately affects their ability to provide proper service to the broader South African public.[474] Hence the government had to ensure that SOEs are complying with corporate governance principles in order to achieve less government dependence of SOEs and to root out mismanagement within SOEs.

In South Africa the principles on corporate governance can be found in the Companies Act 71 of 2008 and the King Reports and Codes on Corporate Governance for South Africa, the Constitution of South Africa and other statutory provisions which legislate the duties and responsibilities of the management of a corporation. The first version of the King Report was published in 1994, with a revision in 2002, the 2009 version which became necessary due to the enactment of the new Companies Act and the latest version in November 2016. Statutory provisions on the financial management of SOEs can be found in the PFMA. SOEs are clearly expected to comply with high standards of corporate governance. This has been confirmed by the court in *South African Broadcasting Corporation Ltd v Mpofu*[475] where the court said that:

> "The conduct of public enterprises must be measured against the relevant principles of the Code and must adhere to best practices. The Code regulates directors and their conduct not only with a view to complying with the minimum statutory

SOEs. She said the President was "ominously silent on the issue of our failing public enterprises and he gave us absolutely no assurance that he would decisively intervene to halt their rot." www.id.org.za (visited on 23/02/2014).

[471] See *Maroga v Eskom Holdings Limited* 2011 JDR 1586 (GSJ). In this case the employment issue was of importance but what also showed clearly from the matter was the lack of proper corporate governance in a SOE which is delivering an essential service to the broader South African public. In the unreported case of *Maroga v Eskom* Case No: 00589/10 Justice Tsoka said that "it is in the public interest and good corporate governance that there is certainty about the leadership of Eskom" para 48.

[472] See *Gama v Transnet Limited* 2010 JDR 0059 (GSJ).

[473] See *South African Airways (Pty) Ltd v Ngqula* 2011 JDR 1305 (GSJ).

[474] This matter gets comprehensively discussed in para 1.2.2 of chapter 5.

[475] [2009] 4 All SA 169 (GSJ) 176.

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> standard but also to seek to adhere to the best available practice that may be relevant to the company in its particular circumstances."[476]

In a separate but concurring judgement Judge Jajbhay confirms the sentiments of Judge Victor regarding the governance of SOEs by saying that:

> "The Constitution of the Republic of South Africa, 1996 recognises the importance of good governance: Section 195 deals with basic values and principles governing public administration. In terms of this section there must be a high standard of professional ethics. In fact this standard must be promoted and maintained. *These principles apply to organs of state and public enterprises: Section 195(2).*[477] This is not surprising, given our history and the advent of our new democratic era. Our Constitution compels government in all of its forms, both through government departments and organs of state (including state-owned enterprises) to adhere to principles of good governance. It is for this reason that the provisions of the Constitution as well as the legislation enacted in terms thereof are applicable to state-owned enterprises. Our Constitution has enshrined certain rights that also have a direct bearing on the corporate governance of state-owned enterprises."[478]

Judge Jajbhay went further and said that:

> "In state-owned enterprises, like other organisations, good corporate governance is ultimately about effective leadership. An organisation depends on its board to provide it with direction, and the directors need to understand what that leadership role entails."[479]

The PFMA contains wide-ranging norms that are aimed to ensure that SOEs comply with high corporate governance standards as envisaged by the court. The PFMA was a big leap for South Africa in regard to the financial governance of SOEs. It

[476] At the time of the case the King Report on Corporate Governance for South Africa 2002 (generally referred to as King II) was still in effect. It has since been replace by the King report on Corporate Governance in South Africa 2016 (generally referred to as King IV).
[477] My emphasis.
[478] *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) 183.
[479] *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) 184.

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governs the financial management of all SOEs in South Africa and how they dispense with their money as SOEs are funded with public money[480] and public resources must be managed efficiently and effectively.[481] Madue states that the Constitution of South Africa and the King Code laid the foundation for the enactment of the PFMA.[482] The PFMA gives effect to Chapter 13 of the Constitution.[483] Chapter 13 determines that "national, provincial and municipal budgets and budgetary processes must promote transparency, accountability and the effective financial management of the economy, debt and the public sector."[484] In *Minister of Justice v FNB of SA*[485] the court also stated that the PFMA is the legislation which was envisaged by Section 216(1) of the Constitution. The section states that:

> "National legislation must establish a national treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing–
>
> (a) generally recognised accounting practice;
>
> (b) uniform expenditure classifications; and
>
> (c) uniform treasury norms and standards."

The Preamble of the PFMA provides as follows:

"To regulate financial management in the national government and provincial governments; to ensure that all revenue, expenditure, assets and liabilities of those governments are managed efficiently and effectively; to provide for the responsibilities of persons entrusted with financial management in those governments;"

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[480] See *Hudson v South African Airways Soc Ltd* [2014] 11 BLLR 1132 (LC) 1138 for this observation by the court in regard to SAA.
[481] See *Passenger Rail Authority of South Africa v Molepo* [2014] 5 BLLR 468 (LC) 480 for this observation by the court in regard to the Passenger Rail Authority of South Africa (PRASA).
[482] SM Madue "Public Finance Management Act, 1 of 1999- a compliance strategy" (2007) 26(3) *Politeia* 306 306.
[483] *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) 184.
[484] See Section 215 of the Constitution of the Republic of South Africa.
[485] [2006] JOL 17004 (Tk) 10.

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Schedules two and three of the PFMA list those SOEs to which the Act applies. Included in schedule two are SOEs such as Denel, Eskom, SAA and Telkom SA Limited, mostly those SOEs which have been corporatized or commercialised, and included in schedule three are SOEs such as Electricity Distribution Industry Holdings (Pty) Ltd, the Amatola Water Board and the Public Investment Corporation Limited.

Already in the 1990s when the ANC-led government adopted the Reconstruction and Development Plan (RDP),[486] they wanted to ensure that government funding given to SOEs is managed properly. Article 5 of the RDP stated that:

> "parastatals which receive 20 per cent of their funding or R20 million (whichever is less) from government, should submit an annual director's report to the relevant ministry, showing how allocated funds were used given the objectives agreed to."

The enactment of the PFMA is not only intended to ensure that this requirement of the RDP was given effect to but also to ensure overall good financial governance of public funds. It is submitted that good financial management of SOEs will positively impact on the lives of all South Africans. If the finances of SOEs are properly managed and in compliance with what is regarded as best practice, the chances of SOEs requiring financial assistance becomes smaller, thus making SOEs less dependent on government funds. This again will reflect in the national budget. Funds that would otherwise have been allocated to SOEs, can be directed towards other essential services for the South African people. In *Gama v Transnet Ltd*[487] the court said that:

> "it is clear that the purpose of the PFMA Act is similarly to hold accountable both the Board and officers (such as Executive Management) of State-owned corporations and other government controlled entities."

[486] The Reconstruction and Development Plan contained the ANC-led government's initial plans on how to address the social and economic problems facing South Africans. It has since been replaced by the National Development Plan.
[487] [2010] JOL 24972 (GSJ) 15-16.

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Accountability for the financial management of SOEs in terms of the PFMA forms part of the overall good corporate governance of SOEs. This had been emphasised in *Gama v Transnet Ltd* when the court said:

> "The fact that the Board and its officers are subject to the express provisions of sections 50 and 51 of the PFMA in regard to their fiduciary duties and their accountability does not denigrate from their actions remaining subject to corporate laws. The *PFMA amplifies these duties and obligations,*[488] which are of special application to all State-owned entitles, whatever form they take."[489]

With the enactment of the PFMA the South Africa government took an important step towards weaning SOEs off wasting government funds by ensuring effective and efficient financial management. However, it is also apparent that rules on corporate governance have not been sufficient to ensure the efficient operation of these undertakings.

4 Concluding Remarks

As this chapter has shown, for a very long time SOEs have formed part of the economies of developed countries just like they do at present in a developing country such as South Africa. Today though, there are fewer SOEs within developed countries than in the decades after World War II, despite the intervention that was required during the 2008 financial crisis. European integration has played a significant role in the divesting of state assets within those EU countries which were discussed in the chapter. The decline of SOEs in the selected EU countries was furthered by greater European integration[490] and the implementation of the internal market in the EU. European integration led to the opening up of industries in which SOEs operated.[491] Due to European integration, which gave rise to strict

[488] My emphasis.
[489] *Gama v Transnet Ltd* [2010] JOL 24972 (GSJ) 20. Although this statement was made in the context of Transnet Limited, it is reasonable to observe that it can be applied to all other SOEs.
[490] European integration and its impact on SOEs within the EU will be discussed fully in chapters three and four which deals with statutory competition law and state aid in the EU respectively.
[491] E Schroter "Reforming the Machinery of Government: The Case of the German Federal Bureaucracy" in R Koch & J Dixon (eds) *Public Governance and Leadership: Political and Managerial Problems in Making Public Governance Changes the Driver for Re-Constituting Leadership* (2007) 251 255 where he refers to the open up of the German transport market.

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supranational rules even in economic matters, the world might never see the level of state intervention that characterised the post-war era. Whether this is an overly optimistic outlook on possible future state intervention in EU member states has to be seen, considering that the world saw in 2008 "the biggest financial and economic crisis in 80 years",[492] which it was certainly not prepared for. The recent migrant crisis and the unfolding events in Eastern Europe, particularly the crisis in Ukraine seems to lead to a rebirth of a new conflict line reminiscent of the Cold War which may also affect the way western market economies think of state intervention and nationalisation of industries. Other factors which could swing the pendulum in the opposite direction again are the continuous financial problems within the euro zone countries and the rise of right-wing political parties all over Europe. It is submitted that beside European integration, the strict appliance of state aid measures[493] within the EU could also have played a role in governments' decision to privatise SOEs instead of intervening more in their economies.[494]

In the context of South Africa, the role of SOEs continues to be significant. President Mandela might have accepted early during his administration as the first democratically elected President of South Africa that state intervention is not necessarily the best option to grow the economy. However, after that it has been generally accepted that a balance is needed between reaching the developmental goals of the government and growing the economy. The sheer number of enterprises listed in the PFMA, whether public utilities, commercialised enterprises or other non-commercialises enterprises, is a clear indication of the level of state intervention which the government still considers necessary in South Africa. The government is clearly of the opinion that socio-economic conditions will not improve if it does not play an active role in the economy and it has to be recognised that for developmental reasons it is sometimes required that certain industries remain state-owned. The fact that the government owns SOEs in many strategic sectors does not mean though that the government delivers as it should. In the recent past the country has been plagued by service delivery protests. These protests are in often addressed at

[492] J Carmassi, D Gros & S Micossi "The Global Financial Crisis: Causes and Cures" (2009) 47(5) *Journal of Common Market Studies* 977 977.
[493] EU state aid measures are comprehensively discussed in chapter four.
[494] See the discussion in para 2 of this chapter on the divestiture of state assets in Britain, France and Germany.

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government and local authorities but in some instances against the poor delivery of a service or goods provided by SOEs such as the provision of clean water, proper sanitation, transport and electricity. These are all sectors where the private sector could play a role and could have significant economic impact. However, again a question mark can be placed on whether private enterprises "will do the right thing" in these sectors even though they might "do things right" as private enterprises are focused on profit maximization and not the correction of socio-economic issues

Since SOEs are representing "hugely strategic resources", it is understandable that the South African government does not just want to follow a "simplistic process of privatization". Various factors need to be taken into consideration when arguments are made for or against state intervention. Such factors include, inter alia, socio-economic circumstances in South Africa, the level of economic development, availability of essential service and goods to all South Africans, infrastructure development and job creation. In the case of South Africa, with all its complex socio-economic problems, many created as a result of past governmental policies, it is easy for the government to justify why certain strategic sectors of the economy are kept as state assets. This is particularly relevant in the context of service utility SOEs. The government and institutions such as the trade union movement, COSATU justifiably worry about the consequences of government divestment of strategic SOEs. Will all South Africans, especially the poor, still be able to access the services and goods which are provided by strategic SOEs at affordable rates? The water supply industry in South Africa can be used as example. One of the government's developmental goals is to provide clean water to every resident of South Africa. Currently each province has its own water supply system in place. On the one hand there are justifiable fears that if the government, local, provincial or national, does not play an active role in water supply, that not everyone in South Africa might get access to water. On the other hand, there are also justifiable arguments that government might not reach the goal of supplying clean water to all South Africans in a quick and efficient way and that this could rather be achieved by private enterprises.[495] Even while a sector of the economy is considered to be one of

[495] Margaret Thatcher's privatisation of the water supply industry in Britain is a good example. The water industry in England had been privatised by the Water Act 1989 (See *Manchester Ship Canal Co Ltd v United Utilities Water plc* All ER 40 [2014] 45. Thatcher was heavily criticized for the privatisation of the water supply

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the many strategic sectors in South Africa, consideration should be given to speedier and more efficient means for achieving the developmental goals of the government. It sometimes takes a bold move to improve the efficiency and speed with which a sector delivers services and goods to ensure that the developmental goals of government are met.

END OF CHAPTER

industry. Thatcher describes the privatisation of the water industry as "politically sensitive" with "much emotive nonsense" and she continued with the process. A few decades after Thatcher's privatisation of the water supply industry, competition in the industry is healthy and customers receive better prices and service due to such competition. See M Thatcher *The Downing Street Years* (1993) 682.

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CHAPTER 3: THE PURPOSE AND FUNCTION OF COMPETITION LAW AND ITS RELEVANCE FOR SOEs

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1 Introduction

The application of competition law to SOEs in certain circumstances became a necessary requirement since many SOEs are now operating beyond the national borders[1] of the countries where they were established and they are also competing directly with "private, profit-maximizing enterprises" in many markets.[2] Now that the characteristics of SOEs and the reasons for their existence[3] are known and in order to determine the extent of the applicability of competition law to these enterprises within the selected jurisdictions, it is necessary to explore the purpose and function of competition law and its relevance for SOEs. This chapter will provide a general overview of competition law systems within the United States of America (US) since statutory competition law has its origin in the US, the three selected EU member states and South Africa. This discussion will shed light on how, if at all, the competition laws of these jurisdictions cover SOEs, their activities and their funding by the state. In the light of the recommendations that are made for South Africa in chapter 5, it is necessary to know whether state funding of economically active SOEs is at all covered by the different competition laws. This discussion is also necessitated by the fact that SOEs have become some of the biggest market players, particular in South Africa, while still enjoying those benefits which have the potential to distort competition. State aid to enterprises within the selected EU member states will be comprehensively discussed in chapter four, while chapter 5 will give a comprehensive description of the positon in South Africa. Hence this chapter only focuses on the competition law systems and their applicability or not to SOEs.

[1] These enterprises are called "state-owned multinational enterprises". See X He, L Eden & MA Hitt "The Renaissance of State-Owned Multinationals" (2016) 58(2) *Thunderbird International Business Review* 117-129. This is particular a phenomenon seen in regard to Chinese SOEs.
[2] DEM Sappington & JG Sidak "Competition Law for State-Owned Enterprises" (2003) 71 *Antitrust Law Journal* 2. See also OECD "State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?" OECD Publishing (2016) (accessible at http://dx.doi.org/10.1787/9789264262096-en).
[3] See para 2 of chapter two.

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2 What is competition and why is it important?

> "Competition is central to the operation of markets, and fosters innovation, productivity and growth, all of which create wealth and reduce poverty."[4]

Many descriptions have been given of the concept of competition by economists, competition and antitrust scholars, courts and government agencies.[5] It has been described as:

> "a process of rivalry between firms seeking to win customers' business. This process of rivalry, where it is effective, impels firms to deliver benefits to customers in terms of prices, quality and choice."[6]

In a South African context one of the most quoted descriptions of competition still remains the one of Judge Van Dijkhorst in *Lorimar Productions Inc. v Sterling Clothing Manufacturers (Pty) Ltd*[7] long before the dawn of South Africa's current competition law regime:

> "In general terms competition involves the idea of a struggle between rivals endeavouring to obtain the same end. It may be said to exist whenever there is a potential diversion of trade from one to another. For competition to exist the articles or services of the competitors should be related to the same purpose or must satisfy the same need."

[4] N Godfrey "Why is Competition important for growth and poverty reduction" OECD Global Forum on International Investment 27-28 March 2008 3.
[5] For examples of such description see J M Clark "What is Competition?" (1925) 3 (3) *University Journal of Business* 217-240; L Abbott "What is Competition?" (1956) 4(7) *Challenge* 6 6-10; B Ross "What Is Competition For?" (1988) 31(2) *Challenge* 42 42-48.
[6] O Black *Conceptual Foundations of Antitrust* (2005) 7.
[7] *Lorimar Production Inc. v Sterling Clothing Manufacturers (Pty) Ltd; Lorimar Productions Inc. v OK Hyperama Ltd; Lorimar Productions Inc. v Dallas Restaurant* 1981 (3) SA 1129 (T).

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Competition is considered to be the "antithesis" to monopoly and has been credited with quicker "goal attainment" amongst people and businesses.[8] Neethling observes that "[a] competitive relationship brings about a struggle for the favour of the client, a struggle which the one obtains, finds it correlate in the prejudice or potential prejudice that the other suffers".[9]

Competition takes place amongst businesses which operate within market economies.[10] A free market economy is "founded upon the principles of free competition, free economic choice, and free development of the individual personality."[11] The notion of "markets" is thus important in regard to competition. What constitutes a market? The United States Court of Appeals[12] stated that according to economists a market exists when buyers and sellers exchange goods or services and that the buyer's desire to buy and the seller's desire to sell are qualified by price. Both parties will only proceed within a certain price range and this makes the market a mechanism through which price is determined. The Competition Tribunal of South Africa stated that, for purposes of a competition law analysis, market definition relies on a number of aspects. These, inter *alia*, include demand side substitution, supply side substitution as well as functionality and nature of the product.[13] Sissors notes that the traditional way of defining a market is through its "generic class of product", the so-called product market, which refers to individuals who have bought the product in the past.[14] The author observes that once the market has been identified through the product, the "most common classifications" used to describe purchasers in that market includes: (i) the size of the market, (ii) the geographical locations of purchasers, (iii) the demographic descriptions of purchasers, (iv) social-psychological characteristics, (v) reasons why products are purchased, (vi) who makes the actual purchases, and who influences the purchaser, (vii) when purchases are made and (viii) how purchasing is done.[15] Other factors

[8] A Kohn *No Contest: The Case against Competition* 2nd ed (2013) 1.
[9] J Neethling *Unlawful Competition* (2008) 3.
[10] Where a "centrally planned economy" exists, competition amongst enterprises is rare since all enterprises are owned by the state.
[11] LH Mai "Erhard's Social Market Economy" (1964) 44 (4) *Southwestern Social Science Quarterly* 329 329.
[12] *Consolidated Gas Co. of Florida, Inc. v City Gas Co. of Florida* 912 F.2d 1262 C.A.11 (Fla.) 1990 1277.
[13] *Telkom SA Ltd / Business Connexion Group Ltd* [2007] 2 CPLR 433 (CT) 453.
[14] JZ Sissors "What Is a Market?" (1966) 30(3) *Journal of Marketing* 17.
[15] JZ Sissors "What Is a Market?" (1966) 30 (3) *Journal of Marketing* 17 17-18.

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stated by Sissors to define a market include age, consumers' environment and geographical places.[16] Competition, however, is not automatically present within a market only because there are a number of enterprises operating within such a market as competition may be restrained in different ways.[17] Competition is thus an integral part of a free market economy.

Five "forces" that shape competition amongst businesses have been identified.[18] These include (i) rivalry amongst existing competitors, (ii) the threat of new entrants, (iii) the threat of substitute products and service, (iv) the bargaining power of suppliers and (v) the bargaining powers of buyers.[19] According to Porter the presence of these "forces" are not always the same in the different industries.[20] It is argued that in some industries some of the "forces" have a stronger presence than others. As an illustration of this observation Porter uses the commercial airline industry. It is stated that in this industry the competition is between two existing competitors namely Boeing and Airbus and that the threat of a new entrant to this industry is relatively small but the "bargaining powers" of the buyers, which are the various airlines throughout the world, are great.[21]

How the realization and existence of competition is viewed differs. Kolasky states that when a lay persons thinks of competition, two possibilities can be observed, firstly a sporting event between two opponents contesting to be the winner and secondly the number of firms competing for business and the more firms you find, the more competitive the behaviour will be.[22] Then there is the traditional economist's view of competition. The traditional economist's concept of competition is not only about rivalry between competitors. A simplified way of referring to the economist's view of competition is when "firms price their output at marginal cost and

[16] JZ Sissors "What Is a Market?" (1966) 30 (3) *Journal of Marketing*17 17-18.
[17] One form of restraint, which is important for purposes of this study, may be through the actions of SOEs which operates within the market.
[18] ME Porter "The Five Force That Shape Strategy" (2008) 86(1) *Harvard Business Review* 78 80.
[19] ME Porter "The Five Force That Shape Strategy" (2008) 86 (1) *Harvard Business Review* 7880.
[20] ME Porter "The Five Force That Shape Strategy" (2008) 86 (1) *Harvard Business Review* 78 80.
[21] ME Porter "The Five Force That Shape Strategy" (2008) 86(1) *Harvard Business Review* 78 80.
[22] WJ Kolasky "What is Competition? A comparison of US and European Perspective" (2004) 49 (1-2) *Antitrust Bulletin* 29 31.

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costs are minimized by internal efficiencies".[23] This is thus a reason to note that the economist studies competition while the businessman practices it.[24]

In regard to the benefits of competition, it is submitted that it offers various benefits to an economy in general and consumers in a market in particular. These benefits are recognised by institutions such as the OECD,[25] the EU Commission[26] and the United Nations Conference on Trade and Development (UNCTAD).[27] Firstly, competition ensures that producers produce goods and services at the lowest cost. This leads to low prices for all as prices are pushed down within a competitive market. Secondly, competition encourages businesses to improve the quality of their goods and services as consumers want to acquire quality goods and services for the best or lowest prices. Thirdly, competition leads to more choice for consumers. Competitors want their goods and service to be the preferred choice of consumers. Hence they will use various methods to ensure that consumers choose their goods and service above those of their competitors. These methods may, inter alia, include discounts, advertising methods to distinguish their products and services from those of competitors and to make them more attractive to consumers, the availability of more product or service options and incentive schemes such as providing free products when consumers spend a certain amount of money on their products and services. Fourthly, competition encourages innovation by businesses as they would like to be always one step ahead of their competitors. Neumann states that competition encourages innovative actions by competitors since no competitor knows what goods and services would be appealing to the consumer.[28] Therefore products and services are tested on the market and if it appeals to the consumer, the competitor makes a beneficial discovery through competition.[29] Cefrey observes that fair competition often leads to new invention in that businesses not only invent ways to make existing products better or to improve existing services but it also ensures

[23] WJ Kolasky "What is Competition? A comparison of US and European Perspective" (2004) 49 (1-2) *Antitrust Bulletin* 29 31.
[24] J Dean "Competition –inside and out" (1954) *Harvard Business Review* 63 63.
[25] For all these benefits see OECD, "The Benefits of Competition Law and Policy for Developed and Developing Countries" (2004) 6 (1-2) *OECD Journal of Competition Law and Policy* 40 40- 56.
[26] See http://ec.europa.eu/competition/consumers/why_en.html (accessed on 12 May 2016).
[27] See the UNCTAD's Manual on the Formulation and Application of Competition Law (2004) 2.
[28] M Neumann *Competition Policy History, Theory and Practice* (2001) 14.
[29] M Neumann *Competition Policy History, Theory and Practice* (2001) 14.

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that businesses invent new products and services.[30] Lastly, competition ensures economic efficiency and development[31] and it protects the consumer from restraint of trade and monopoly.[32]

In order to understand the crucial role of competition between enterprises and how it can help to grow modern economies, it is important to refer to the history of competition and how economics as a science came to be used for competition law analyses.

3 History of the Competition Concept in Economics

3 1 Important epochs and economists

Different economic epochs are important for the study since the different theories established and followed by economists during these epochs "shapes today's actions of governments, enterprise [and] unions" towards economic competition.[33] No discussion on the history of competition is complete without reference to Adam Smith's[34] well known work, the *Nature and Causes of the Wealth of Nations*[35] published in 1776 and it has been said that it is "common cause" to start any discussion on the economic history of competition with an exploration of Adam Smith's work.[36] Adam Smith's[37] book established the "roots of competition" and the belief that "uncontrolled, apparently chaotic, and completely self-interested behavior of businesspersons produces more welfare than government command and

[30] H Cefrey *The Sherman Antitrust Act: Getting Big Business Under Control* (2004) 6.
[31] See the UNCTAD's Manual on the Formulation and Application of Competition Law (2004) 2.
[32] AJ DeLuca "Requirements for competition" (1988) 57(2) *Antitrust Law Journal* 511 515.
[33] See RD Wolff and SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 1.
[34] Adam Smith, David Ricardo, John Stuart Mill, Nassua Senior and John Cairnes are all considered to be classical economist. See MN Rothbard "Competition and the Economists" (2012) 15 (4) *Quarterly Journal of Austrian Economics* 396 396-409.
[35] Described as a "formal treatise heralded by scholars as "equal to what has ever appeared on any subject of science whatever" and securing for its author "as near an approach to immortality as a fall to any economic writer". See JH Hollander "The Work and Influence of Ricardo" in J C Wood (ed) *David Ricardo: Critical Assessments* (1985) 42 42. See also J H Hollander "Adam Smith 1776-1926" (1927) 35(2) *Journal of Political Economy* 153 153-197.
[36] PJ McNulty "A Note on the History of Perfect Competition" (1967) 75 (4) *Journal of Political Economy* 395 395.
[37] Adam Smith has been referred to as the "founding father of the profession [economics]" in particular classical economics and his contribution to economics has been compared to what Darwin did for science. See G Niels, H Jenkins & J Kavanagh *Economics for Competition Lawyers* (2011) 2; and K McCreadie *Adam Smith's The Wealth of Nations: A Modern-day Interpretation of an Economic Classic* (2009) 2. For further reading see also P Sutherland & K Kemp *Competition Law of South Africa* (2014) 1-7.

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control".[38] Writings before Smith's book though, indicate that the concept of competition already existed long before Smith's famous work.[39] McNulty thus rejects the notion that the entry of the concept of competition into economics can be attributed to Smith. The author notes that "neither the concept nor its analytical function" originated in Smith's work.[40] Smith's pivotal role in establishing the concept of competition as a "principle of economic society" is however acknowledged.[41]

What was the "Smithian concept of competition"? The literature which deals with Smith's theory on competition is unanimous that Smith saw competition as a "behavioural process" through which individuals ensured that they defeat their rivals.[42] It is noted that to Smith competition was essentially a rivalry process between those who buy and those who sell goods at marginal cost but it was also a "process by which commodities and services were discovered, produced efficiently, and allocated to their most highly valued uses in order to respond to the problem of scarcity."[43] Rothbard observes that Smith viewed competition in the "common-sense way" the same as businessmen view it, meaning it to be a rivalry between two or more independent persons or firms.[44] Smith placed particular emphasis on the freedom to enter an industry and used this as a yardstick to determine the level of competition in an industry.[45] While recounting Smith's approach to competition, Stigler identified five conditions for competition to be present, attributed to Smith. These conditions are firstly, that competitors do not collude, secondly, that the number of potential and current competitors must be sufficient to eliminate any gain which is extraordinary, thirdly, knowledge of market opportunities by potential or

[38] H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2006) 15.
[39] R van den Bergh & PD Camesasca *European Competition Law and Economics: A Comparative Perspective* (2001) 16.
[40] PJ McNulty "A Note on the History of Perfect Competition" (1967) 75 (4) *Journal of Political Economy* 395 395.
[41] PJ McNulty "A Note on the History of Perfect Competition" (1967) 75 (4) *Journal of Political Economy*395 395-396. McNultry states that "His [Smith's] contribution with respect to the concept of competition was the systematization of earlier thinking on the subject and, more importantly, the elevation of competition to the level of a general organizing principle of economic society-an achievement far greater, surely, than that of any of his predecessors."
[42] See D Geradin, A Layne-Farrar & N Petit *EU Competition Law and Economics* (2012) para 2.10.
[43] GM Anderson & R D Tollison "Adam Smith's Analysis of Joint-Stock Companies" (1982) 90(6) *Journal of Political Economy*1237 1238.
[44] MN Rothbard "Competition and the Economists" (2012) 15 (4) *Quarterly Journal of Austrian Economics* 396 396. For further reading on the economic theories of David Ricardo see D Ricardo *On the Principles of Political Economy and Taxation* 3rd ed (1821).
[45] GM Anderson & RD Tollison "Adam Smith's Analysis of Joint-Stock Companies" (1982) 90 (6) *Journal of Political Economy* 1237 1239.

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current competitors, fourthly, the freedom to act on the knowledge of these market opportunities and lastly, that resources must flow in those directions and in those quantities as desired by their owners.[46]

Other well-known classical economists and fierce followers of Smith's theory on competition continued to apply and observe Smith's theory with very little or no changes. It is stated that David Ricardo, the first major economist to follow Smith, did not add anything of significance to Smith's view on competition and that Smith's position was closely followed in instances where he made reference to monopolies as Ricardo also attacked British colonial monopolies which were already fiercely criticised by Smith.[47] The classical economist, John Stuart Mill[48] continued in the tradition of Smith and Ricardo.[49] Only at a later stage was there a certain degree of diversion from the "Smithian tradition" in regard to competition.

Nassua Senior and John Cairnes broadened Smith's description of a monopoly. Senior believed that if the conditions for producing a commodity were not equal, monopolistic behaviour was present. Cairnes deviated from earlier economic theory on the meaning of free competition.[50] Smith and those following his theory on the meaning of free competition viewed it as the process which attain prices which is equal or very close to the production cost, while Cairnes concentrated on the result which was reached, namely that the price and the production costs was equalised and not the process to reach such a result.[51] Cairnes is considered to be one of the last classical economists before the neoclassical economist introduced changed theories regarding competition.

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[46] GJ Stigler "Perfect Competition, Historically Contemplated" (1957) 65 (1) *Journal of Political Economy* 1 2.
[47] MN Rothbard "Competition and the Economists" (2012) 15(4) *Quarterly Journal of Austrian Economics* 396 397.
[48] For more reading on the theories of John Stuart Mill see J S Mill *Principles of Political Economy: with Some of their Applications to Social Philosophy* 2nd ed (1848). See also P D Groenewegen "Was John Stuart Mill a Classical Economist?" (2005) 13 (3) *History of Economic Ideas* 9 9-31.
[49] MN Rothbard "Competition and the Economists" (2012) 15(4) *Quarterly Journal of Austrian Economics* 396 398.
[50] MN Rothbard "Competition and the Economists" (2012) 15 (4) *Quarterly Journal of Austrian Economics* 396 399-400.
[51] MN Rothbard "Competition and the Economists" (2012) 15(4) *Quarterly Journal of Austrian Economics* 396 399-400. See also GJ Stigler "Perfect Competition, Historically Contemplated" (1957) 65 (1) *Journal of Political Economy* 1 1-17.

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Only in 1871 did competition receive "explicit and systemic attention in the mainstream of economics".[52] The view is that the shift in the late 1870s from macroeconomics, which focused on the economy and its growth as a whole, to microeconomics, which focused on an economy influenced by decisions made by individuals and firms, was the start of the neoclassical economic theories and between 1870 and 1930 the foundation of the neoclassical economic theory was established.[53] Economists such as Cournot, Dupuit, Jevons, Edgeworth, Clark and Knight are credited with the broadening of Adam Smith's theory on competition by adding a mathematical approach to the analysis of markets and by observing that market prices "depend on the subjective value of goods".[54] This established the "price theory".[55]

The neoclassic economists did not opposed or reject the classical theory in regard to the concept of competition but attempted to get a better understanding of competition. They did this by using "advanced apparatus", which is the "equilibrium-based model".[56] Neoclassical theories introduced the concept of "perfect competition". "Perfect competition" was achieved by a market with multiple sellers and buyers and these market players ensured that they benefitted from the "law of demand and supply".[57] Competition is perfect when demand fully meets supply.[58] "Perfect competition" does not focus on the behaviour of a business but purely on the effect of the competitive process.[59] Conditions which indicate "perfect competition" are believed to include: firstly, the presence of many buyers and sellers without any single buyer's or seller's action impacting on the market price of a product; secondly, the knowledge by producers and consumers of events within a

[52] GJ Stigler "Perfect Competition, Historically Contemplated" (1957) 65 (1) *Journal of Political Economy* 1 1.
[53] RD Wolff & S A Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 15.
[54] AS Papadopoulos *The International Dimension of EU Competition Law and Policy* (2010) 269.
[55] AS Papadopoulos *The International Dimension of EU Competition Law and Policy* (2010) 269.
[56] O Andriychuk "The Concept of Perfect Competition as the Law of Economics: Addressing the Homonymy Problem" (2011) 62 (4) *Northern Ireland Legal Quarterly* 523 528.
[57] O Andriychuk "The Concept of Perfect Competition as the Law of Economics: Addressing the Homonymy Problem" (2011) 62 (4) *Northern Ireland Legal Quarterly* 523 528.
[58] O Andriychuk "The Concept of Perfect Competition as the Law of Economics: Addressing the Homonymy Problem" (2011) 62 (4) *Northern Ireland Legal Quarterly* 523 527.
[59] O Andriychuk "The Concept of Perfect Competition as the Law of Economics: Addressing the Homonymy Problem" (2011) 62 (4) *Northern Ireland Legal Quarterly* 523 527. See also P Sutherland & K Kemp *Competition Law of South Africa* (2014) 1-8 and A S Papadopoulos *The International Dimension of EU Competition Law and Policy* (2010) 269.

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market on which they can act; thirdly, homogenous products in markets which ensures that consumers do not go after the products of "alternative suppliers"; fourthly, both firms and consumers act in their own economic interest; and lastly, that there are no barriers to the movement of any products.[60]

The above economic theories which promoted individual economic freedoms and limited state intervention in the markets came under threat during the Great Depression, when state intervention in markets, became a necessity.[61] Neither the classical economic theory nor the neoclassical economic theory prepared anyone for an event such as the Great Depression.[62] Governments had to act to ameliorate the impact on their economies and societies. The Great Depression "played havoc with laissez faire"[63] since governments had to interfere with the individual economic freedoms required by the classical and neoclassical economic theories. The inability of classical and neoclassical theories to provide solutions for the economic problems which arose during the Great Depression, led to the rise of the Keynesian theory on competition.[64] One of the fundamentals of the Keynesian theory is that the state should play a bigger role in markets than is attributed to it by the classical and neoclassical theories.[65] Even though some state intervention was favoured by the Keynesian theory, it is argued that it was not an "attack on the virtues of the market economy",[66] but was necessary due to the economic conditions created in 1933, conditions for which there were no proper solutions in the existing economic theories. The American President at the time, Franklin Rooseveldt, started to accept the Keynesian theory to save America's economy.[67] As a result federal programmes were created to employ millions of unemployed Americans and laws were put in place to regulate free markets.[68] The Keynesian approach of state involvement in the economy was an integral part of economies until the 1970s when the state's

[60] D Kallay *The Law And Economics Of Antitrust And Intellectual Property An Austrian Approach* (2004) 17.
[61] See RD Wolff & SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 15.
[62] See RD Wolff & SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 15.
[63] P Berton *The Great Depression: 1929-1939* (2002) 14.
[64] See RD Wolff & SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 17.
[65] RD Wolff & SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 17.
[66] R Marris *Reconstructing Keynesian Economics with Imperfect Competition: A Desktop Simulation* (1991) 5.
[67] RD Wolff & S A Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 17.
[68] RD Wolff & S A Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 17.

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involvement in the economy was again questioned.[69] It is said that the election of leaders such as Margaret Thatcher and Ronald Reagan was indicative of the belief that the state needed to play a reduced role in the economy and that there needed to be a return to "individual initiative and responsibility."[70] The application of Keynesian theories in capitalist economies thus started to fade with Margaret Thatcher's historically important privatisation programme which commenced a worldwide trend. Many states were gradually withdrawing from regulating markets and being active as an economic player.

However, the 2008 financial crisis[71] saw a return to Keynesian economics. Governments all over the world had to intervene to save failing banks and other financial institutions.[72] State intervention was necessary to correct the failures of the free market and to avoid an even bigger economic crisis. Any impact on competition between enterprises by such state intervention would have been dwarfed by the severe economic disaster that would have ensued had there been no intervention. In the EU, for example, provision was made through special regulations, for the assistance of banks and financial institution by the governments.[73] Not only did specific rules limit the impact on competition but it also ensured that states stayed true to the state aid regime that applies within the EU. The state aid that was thus provided occurred within a regulatory framework. Hence state involvement in the economy will continue for as long as governments feel the need to correct market failure.

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[69] RD Wolff & S A Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 21.
[70] RD Wolff & SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 22.
[71] See chapter two for a short reference to this crisis.
[72] RD Wolff & SA Resnick *Contending Economic Theories: Neoclassical, Keynesian, and Marxian* (2012) 24
[73] See Communication from the Commission on the application of the State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') *Official Journal of the European Union* No.216/1 [2013]; Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No. C 16/01 [2009]; The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis *Official Journal of the European Union* No. C 270/02 [2008]. See also P Nicolaides & IE Rusu "The financial crisis and state aid" (2010) 55 (4) *Anti-trust Bulletin* 759 760 and U Soltesz & C Von Kockritz The "temporary framework" - the Commission's response to the crisis in the real economy" (2010) 31(3) *European Competition Law Review* 106 106- 116.

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4 Competition law (antitrust law) as protection measure for competition

4 1 Introduction

Competition is safeguarded through the implementation of competition laws. Competition laws internationally have the same fundamental features namely the regulation of anticompetitive conduct by private parties and the regulation of mergers or combinations.

Sweeney states that:

> "Competition law (or antitrust law) is generally taken to refer to the laws that regulate private anticompetitive conduct……there are certain core provisions that underpin nearly all competition law regimes. These include: prohibition of anticompetitive collusion (such as price fixing and market sharing by competitors), prohibitions on anticompetitive vertical arrangements (such as exclusive distribution agreements), prohibitions on anticompetitive conduct by dominant firms… and prohibitions on mergers that substantially reduce competition"[74]

Further description includes those by Winslow and Neumann. Winslow describes competition law as follows:

> "In general, competition law prohibits or provide a means to address conduct that is 'anticompetitive'- that is conduct that does or is likely to restrict output and increase price, impede market expansion or new entry, reduce product or service quality, or stifle innovation. They also prohibit firms from obtaining market power by merger or by any means other than skill, foresight, and industry."[75]

Neumann notes that countries which apply their competition legislation in a strict way display "superior international competiveness."[76]

[74] B Sweeney *The Internationalisation of Competition Rules* (2010) 12-13.
[75] B Sweeney *The Internationalisation of Competition Rules* (2010) 12-13.
[76] M Neumann *Competition Policy History, Theory and Practice* (2001) 164.

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Competition law is one element of competition policy.[77] Jenny identifies other elements of competition policy including "deregulation", "trade liberalization" and "privatization".[78] Competition law has also been described as "one of the means by which states regulate the behaviour of players in the free-market economies."[79] Many countries, including South Africa, have free market economies. Competition in the sense that is relevant for competition law can occur only in these economies. Countries with a free market economy generally have competition policies in place to regulate competitive relations. Competition law has both economic and political goals.[80] Buttigieg states that these goals may be linked to the economic circumstances within a country or its region and it may change with the passing of time and a change in "political and scholarly ideologies."[81] It is further stated that whatever the economic circumstances within different economies are, the consumer's protection should be at the forefront of all goals of competition policy and law.[82] Competition law thus sets the rules for competitive relations and it attempts to eliminate all activities by competitors which could be harmful to the economy. Its application is triggered by any uncompetitive or prohibited practices.

4 2 The different "schools of thought" on competition law

A number of "schools of thoughts" have developed over the decades, which established different theories in regard to: competition law, the reasons for its importance and the economic analysis of competition. These schools include the ordoliberals, the Harvard economists, the Chicago economists,[83] the post-Chicago

[77] F Jenny (then Chairman OECD Competition Committee) *Competition law and Competition Policy: Lessons from Developing and Transition Economies* National Investment Reform Agenda Workshop- Lebanon 19 April 2007 Grand Serail Beirut Lebanon.
[78] F Jenny (then Chairman OECD Competition Committee) *Competition law and competition policy: lessons from developing and transition economies*, National Investment Reform Agenda Workshop- Lebanon 19 April 2007 Grand Serail Beirut Lebanon.
[79] P Sutherland & K Kemp *Competition Law of South Africa* (2000) 1.
[80] R J Van Den Bergh & PD Camesasca *European Competition Law and Economic* (2001) 1.
[81] E Buttigieg *Competition Law: Safeguarding the consumer interest. A Comparative Analysis of US Antitrust Law and EC Competition Law* (2009) 1.
[82] E Buttigieg *Competition Law: Safeguarding the consumer interest. A Comparative Analysis of US Antitrust Law and EC Competition Law* (2009) 1.
[83] See T A Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 346.

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economist and the Austrians economists.[84] It is important to know how different schools of thought view competition and the law that governs it.

Europe was in a dire economic position after World War II. Economies needed to be rebuilt. After the war it was expected that state control of economies would be seen as the norm all over Europe and that competition and individual freedoms in the market place would be limited.[85] However by the 1960s the market economy and the "process of competition" became the important measures for a successful economy, particularly in Germany.[86] These developments were a result of the economic theories of a certain group of scholars based at the University of Freiburg.[87] The Freiburg "school of thought" also known as the ordoliberals influenced the German economic policy after World War II[88] and it is widely believed that they were behind the German social market economy (the Soziale Marktwirtschaft) implemented by Ludwig Erhard, the Vice- Chancellor and Minister for Economic Affairs of the German Federal Republic.[89] Their ideas had a huge impact on the social and economic policies in Europe.[90] Gerber states that the Freiburg School was in agreement with former thinkers on the importance of a competitive economic system in order to ensure a "prosperous, free and equitable society".[91] They believed that the competition principles should form part of a "constitutional framework".[92] One of their objectives was to rid Germany of the "cartelization" of its industries, which started to take effect in 1873[93] and which continued during the Weimar Republic after World War I and under Adolf Hitler's Nazi regime, as they wanted "private

[84] For further reading on some of these "schools of thought" see P Sutherland & K Kemp *Competition Law of South Africa* (2014).
[85] See D J Gerber "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New Europe" (1994) 42 (1) *American Journal of Comparative Law* 25 25.
[86] See D J Gerber "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New Europe" (1994) 42 (1) *American Journal of Comparative Law* 25 25.
[87] See D J Gerber "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New Europe" (1994) 42 (1) *American Journal of Comparative Law* 25 25.
[88] KJ Cseres *Competition Law and Consumer Protection* (2005) 28-29.
[89] See W Bonefeld "Freedom and the Strong State: On German Ordoliberalism" (2012) 17 (5) *New Political Economy* 633 633-634. For further reading see also P Sutherland & K Kemp *Competition Law of South Africa* (2014) 1-25.
[90] See DJ Gerber "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New Europe" (1994) *American Journal of Comparative Law* 25 25.
[91] See DJ Gerber "Constitutionalizing the Economy: German Neo-Liberalism Competition Law and the "New Europe"" (1994) 42 (1) *American Journal of Comparative Law* 25 25.
[92] See DJ Gerber "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New Europe"" (1994) 42(1) *American Journal of Comparative Law* 25 25.
[93] E Solsten *Germany: A country Study* (1999) 250-251.

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power in a free society".[94] The ordoliberals believed that economic goals could be achieved through the application of legal disciplines such as "cartel" (competition law), contract and corporate law.[95] They further wanted the state to play a significant role in the promotion of competition and therefore a strong state was required to protect "economic liberty" since any weakness on the part of the state would not have led to "economic liberty".[96] Economists such as Walter Eucken, Franz Bohm, Alexander Rustow, Wilhelm Ropke and Alfred Muller-Armack are the "founding fathers" of this "school of thought".[97]

The theories of the Harvard "school of thought" (Harvard School) or the "structuralists" had a profound impact on antitrust law (competition law) in America during the 1950s and 1960s.[98] The theories of the Harvard School were adopted by the courts and antitrust agencies during the 1960s and the 1970s.[99] The Harvard School adopted a theory whereby they assumed that when a firm had market power, it will act in an anti-competitive manner.[100] Hence they proposed that courts and competition authorities should presume the illegality of mergers, joint ventures of any agreements which would lead to market power even though it could benefit consumers.[101] They followed a "structural approach" in condemning anti-competitive practices. The structural approach of the Harvard School was however relaxed in the works of Donald Turner.[102] He no longer viewed structure as an automatic indication

[94] See DJ Gerber "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New Europe"" (1994) 42 (1) *American Journal of Comparative Law* 25 27-31.
[95] KJ Cseres *Competition Law and Consumer Protection* (2005) 29.
[96] See W Bonefeld "Freedom and the Strong State: On German Ordoliberalism" (2012) 17 (5) *New Political Economy* 633 633-634.
[97] See W Bonefeld "Freedom and the Strong State: On German Ordoliberalism" (2012) 17 (5) *New Political Economy* 633 633-634.
[98] S Stroux *US and EC Oligopoly Control* (2004) 38.
[99] See TA Piraino,Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 346.
[100] See TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 346. For further reading see also P Sutherland & K Kemp *Competition Law of South Africa* (2014) 1-26.
[101] See TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal*345 346.
[102] Donald Frank Turner was a professor in antitrust law at the Harvard Law School. With a law degree from Yale University and a PhD in economics from Harvard University he was the perfect person to be chosen to head the Antitrust Division of the US Department of Justice, which he did from 1965 to 1968. For more on Turner see W G Shepherd "Donald Turner and the economics of antitrust" (1996) 41 *Antitrust Bulletin* 935 935 and SG Breyer "Donald F. Turner" (1996) 41 *Antitrust Bulletin* 725 725.

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of anti-competitive behaviour but rather as a factor that required closer investigation.[103] This is mainly the approach that is followed today.[104]

The Harvard School's structuralist approach however came under fire from scholars at Chicago University. Unlike the Harvard School who focused on the market power of a firm, the Chicago "school of thought" (Chicago School) or the "behavioralists" adopted a theory which focused on the objective of antitrust (competition law). Scholars associated with the Chicago school found no evidence that "Congress's intent under the antitrust laws was to protect individual competitors against large firms' exercise of market power."[105] As a result their approach was that the antitrust laws were designed simply to increase the efficiency of the American economy and that only economic efficiency foster "conditions that maximized wealth" and consumer welfare.[106] They focused on the "efficiency gains to society from large size" and did not consider concentrated markets to be bad for competition.[107] Posner credits Aaron Director for establishing the basic ideas of the Chicago School.[108] In the late 1970s,[109] the courts and antitrust agencies started to follow this approach since they were no longer willing to prohibit competitive conduct on its face.[110] Instead, the effects of particular conduct on consumers had first to be investigated before any finding on its legality could be made.[111]

The Chicago school's approach has also been altered by the "post-Chicago school of thought" (the post-Chicago school). It developed out of the observation that the Chicago school's approaches were "too simplistic to take real-world phenomena into

[103] See H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2008) 37.
[104] See H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2008) 37.
[105] TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 350.
[106] TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 350.
[107] D Kallay *The Law And Economics of Antitrust And Intellectual Property: An Austrian Approach* (2004) 18.
[108] RA Posner "The Chicago School of Antitrust Analysis" (1979) 127 (4) *University of Pennsylvania Law Review* 925 925.
[109] See TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 346.
[110] See TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 346.
[111] See TA Piraino Jr "Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st" (2007) 82 *Indiana Law Journal* 345 346.

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account"[112] and that certain "market structures" and "collaborative activity" may have anti-competitive consequences.[113] Hovenkamp states that those who found markets to be more complex and varied than what the Chicago school was willing to admit wanted an antitrust policy that was more sensitive to market imperfections.[114] He further states that the post-Chicago theorists (i) had less confidence in markets; (ii) were more fearful of strategic anticompetitive behaviour by dominant firms; and (iii) had more faith in the efficacy of government intervention.[115] Hence the post-Chicago theorists developed new game theories and empirical tools "to study complex market structures".[116] Baker states that the new empirical tools allowed better measurement of incentives, conduct and effects.[117] By using these tools to analyse strategic behaviour by market participants, the post-Chicago school showed that it could be anti-competitive.[118] The acknowledgment that strategic behaviour by market participants could be anti-competitive, led the number, variety and likelihood of anti-competitive practices to become "open ended".[119] Baker states that these developments started to influence antitrust policy during the 1990s.[120] It started to manifest during H.W. Bush's administration when the new merger guidelines were adopted and also in the Supreme Court's decision in *Eastman Kodak Company v Image Technical Services Incorporated*.[121] In the *Kodak* case a number of independent services organizations who serviced photocopiers and micrographic equipment manufactured by Kodak, instituted action against Kodak after it adopted policies to limit the availability of parts. Kodak was a manufacturer and seller of photocopiers and micrographic equipment and it also sold service and replacement parts for its equipment. The independent services organizations alleged that Kodak's

[112] See H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2008) 38.
[113] See H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2008) 38.
[114] H Hovenkamp "Post-Chicago Antitrust: A Review and Critique" (2001) *Columbia Business Law Review* 257 258.
[115] H Hovenkamp "Post-Chicago Antitrust: A Review and Critique" (2001) 2001 (2) *Columbia Business Law Review* 257 266.
[116] F Etro *Competition, Innovation, Antitrust: A Theory of Market Leaders and Its Policy Implications (*2007) 176.
[117] JB Baker "A Pre-Face to Post-Chicago Antitrust" in A Cucinotta, R Pardolesi & R van den Bergh *Post-Chicago Developments in Antitrust Law* (2002) 60 69.
[118] Etro *Competition, Innovation, Antitrust: A Theory of Market Leaders and Its Policy Implications* 176.
[119] H Hovenkamp "Post-Chicago Antitrust: A Review and Critique" (2001) 2001(2) *Columbia Business Law Review* 257 269.
[120] JB Baker "A Pre-Face to Post-Chicago Antitrust" in A Cucinotta, R Pardolesi & R van den Bergh *Post-Chicago Developments in Antitrust Law* (2002) 60 69.
[121] 504 U.S. 451, 112 S. Ct. 2072, 119 L. Ed. 2d 265 (1992).

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policies to limit the availability of parts to them made it difficult for them to compete with Kodak in servicing Kodak's photocopiers and micrographic equipment in that it amounted to a tying arrangement between Kodak parts and service.[122] The issue which the court had to determine was whether Kodak's lack of market power in the primary equipment market precluded the possibility of market power in derivative aftermarkets. Tying arrangements where the seller has "appreciable economic power" in the "tied product market" is considered to be illegal in terms of a per se rule.[123] Hence, a judicial inquiry into its "procompetitive benefits and its anticompetitive costs" is not necessary. In this case the court undertook a judicial inquiry after having found that there was sufficient evidence of a tying arrangement. The court used "appreciable economic power" in the "tied product market" as a measure to determine whether there could be any anticompetitive effects by the tying arrangement.[124] It stated that in determining the existence of market power it has to closely examine the economic reality of the market at issue. It did not favour any existing economic theory but focused on the facts[125] and decided from the evidence offered that it was reasonable to infer that Kodak had market power to raise prices and drive out competition in the aftermarkets.[126] Baker states that the Supreme Court's openness to accept economic theories outside of the Chicago school's price theory showed its acceptance of new antitrust possibilities,[127] while Klein states that the Kodak case can be correctly described as "emphasizing an examination of the facts of a situation before accepting an economic theory."[128]

The Austrian "school of thought" (the Austrian school) evolved around the ideas and theories of a group of Austrian scholars that included Carl Menger, Ludwig von

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[122] *Eastman Kodak Company v Image Technical Services Incorporated* 504 U.S. 451, 112 S. Ct. 2072, 119 L. Ed. 2d 265 (1992) 455.
[123] *Eastman Kodak Company v Image Technical Services Incorporated* 504 U.S. 451, 112 S. Ct. 2072, 119 L. Ed. 2d 265 (1992) 461.
[124] *Eastman Kodak Company v Image Technical Services Incorporated* 504 U.S. 451, 112 S. Ct. 2072, 119 L. Ed. 2d 265 (1992) 464.
[125] See in this regard B Klein "Market Power in Antitrust: Economic Analysis after Kodak" (1993) 3 *Supreme Court Economic Review* 43 43.
[126] *Eastman Kodak Company v Image Technical Services Incorporated* 504 U.S. 451, 112 S. Ct. 2072, 119 L. Ed. 2d 265 (1992) 477.
[127] JB Baker "A Pre-Face to Post-Chicago Antitrust" in A Cucinotta, R Pardolesi & R van den Bergh *Post-Chicago Developments in Antitrust Law* (2002) 60 69.
[128] B Klein "Market Power in Antitrust: Economic Analysis after Kodak" (1993) 3 *Supreme Court Economic Review* 43 44.

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Mises, Joseph Schumpeter and Friederich Hayek.[129] Even though different approaches to competition exist amongst these scholars, Kallay identifies those aspects on which the scholars have found common ground and these, included the emphasis on the role of the entrepreneur, the importance of product differentiation and the belief that competition is a dynamic process.[130] The dynamic process advocated by the Austrian school became part of modern economic theory through the views of Joseph Schumpeter, the so-called "prophet of innovation". Schumpeter, described as "a third generation member of the Austrian school", is one of many prominent economists of the early twentieth century who was initially associated with the Austrian school and the most prominent theory on dynamic competition can be attributed to Schumpeter.[131] The Austrian school's approaches are considered to be the "roots of Schumpeter's thoughts" and it is argued that certain elements of his theory derive from the Austrian school.[132] Schumpeter's "entrepreneurial innovation" theory was mostly based on Carl Menger's work on the "entrepreneurial function" in economics.[133] This, though, is not surprising since Schumpeter studied under some of the members of the Austria school.[134] Schumpeter is thus associated with the "Austrian tradition in the everyday language of economics[135] but in the course of time Schumpeter decided to move away from the views held by the Austrian school.[136]

Schumpeter believed that consumer welfare can be achieved through competition which involves "new products, new technologies, new sources of supply, and new forms of business organization."[137] All these could be achieved through innovation and therefore "innovative competition". Roberts summarises how greater competition

[129] D Kallay *The Law And Economics Of Antitrust And Intellectual Property: An Austrian Approach* (2004) 19.
[130] D Kallay *The Law And Economics Of Antitrust And Intellectual Property: An Austrian Approach* (2004) 21.
[131] J Ellig & D Lin "A Taxonomy of Dynamic Competition Theories" in J Ellig (ed) *Dynamic Competition and Public Policy: Technology, Innovation, and Antitrust Issues* (2001) 16 16.
[132] RJ Wolfson "The Economic Dynamics of Joseph Schumpeter" (1958) 7(1) *Economic Development and Cultural Change* 31 32.
[133] PJ Boettke *The Elgar Companion to Austrian Economics* (1994) 103.
[134] RJ Wolfson "The Economic Dynamics of Joseph Schumpeter" (1958) 7(1) *Economic Development and Cultural Change* 31 32.
[135] S Gloria-Palermo *Evolution of Austrian Economics: From Menger to Lachmann* (1999) 3.
[136] VJ Vanberg "Schumpeter and Mises as 'Austrian Economists'" (2015) 25 (1) *Journal of Evolutionary Economics* 91 92.
[137] J Ellig & D Lin "A Taxonomy of Dynamic Competition Theories" in J Ellig (ed) *Dynamic Competition and Public Policy: Technology, Innovation, and Antitrust Issues* (2001) 16 16.

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can lead to innovation or how innovation can lead to competition when he states that:

> "An innovative new product tends to face low competition at the point of introduction and therefore earns relatively high profits. These high profits attract imitators, which increase the level of competition faced by the product as time passes. Finally, this increased competition translates into reduced profits for the firm producing the new product."[138]

The goal of competition is reached, when the innovated product or service is available at affordable prices to all, not only to the few that could initially afford it when it was introduced. It is at this point when innovation starts benefiting more people and there is no doubt that innovation contributes to "human welfare". Baker is thus correct when he states that "[f]rom one generation to the next, innovation is undoubtedly a central determinant of the welfare of humankind."[139]

Although innovation was not initially an obvious part of the general antitrust narrative, people such as Joseph Schumpeter and Kenneth Arrow[140] ensured that it is now accepted[141] that free and fair competition between enterprises encourages innovation[142] of products and processes.[143] Today the theory of dynamic competition is attributed to Schumpeter and his well-known work, *Capitalism, Socialism and Democracy*. Schumpeter believed that the introduction of new products and services drives capitalism.[144] Schumpeter continues to be known as the "Prophet of

[138] PW Roberts "Product Innovation, Product-Market Competition and Persistent Profitability in the U.S. Pharmaceutical Industry" (1999) 20(7) *Strategic Management Journal* 655 656.
[139] JB Baker "Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation" (2007) 74(3) *Antitrust Law Journal* 575 576.
[140] Kenneth Arrow viewed competition as favourable for innovation. See JB Baker "Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation" (2007) 74(3) *Antitrust Law Journal* 575 575. See also BA McDaniel *Entrepreneurship and Innovation: An Economic Approach* (2015) 112.
[141] For example in *U.S. v Microsoft Corporation*, 253 F.3d 34 (2001) 361 the court stated that "In a competitive market, firms routinely innovate in the hope of appealing to consumers."
[142] Opposing views such as those of Kenneth Arrow who believed competition and not monopoly encourage innovation can be credited for this. JB Baker "Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation" (2007) 74 (3) *Antitrust Law Journal* 575 578.
[143] See for example JB Baker "Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation" (2007) 74(3) *Antitrust Law Journal* 575 575-602. Further reading on innovation and competition can be found in D Encaoua & A Hollander "Competition Policy and Innovation" (2002) 18(1) *Oxford Review of Economic Policy* 63 63-79.
[144] TK McCraw *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (2007) 353.

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Innovation" and remains today one of the most influential thinkers about the concept of innovation.[145] Schumpeter was thus not a follower of the theory of "perfect competition", which forms part of neo-classical approach and which assumes the presence of many firms within a market which do not have the capabilities to control the market, and also of many buyers and seller within a market with knowledge of all products or service to be sold and bought.[146] Schumpeter did not necessarily see monopolies as a threat to competition since his view was that the "perennial gale of creative destruction" would destroy monopolies if such firms did not remain innovative. He believed that monopolists or bigger firms rather than firms in competitive markets equal innovation.[147] Schumpeter also believed that "monopoly power is needed to create the 'new' but also because it is the 'new' that ultimately destroys monopoly power".[148] Schumpeter argued that innovation leads to "gales of creative destruction".[149] Such "gales of creative destruction" lead to changes in markets, which challenge "equilibrium economics" in favour of "evolutionary economics". Entrepreneurship, which contributes to economic development by introducing the "new", is encouraged by such changes. Gavil and First believe that elements of "creative destruction" include (i) new consumers (ii) new products (iii) new markets (iv) new methods of production and transportation, and (v) new forms of organizations.[150] It is submitted that these elements are today all guaranteed through competition which justifies protection.

[145] M Dodgson & D Gann *Innovation: A Very Short Introduction* (2010) 20.
[146] TK McCraw *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (2007) 353.
[147] JB Baker "Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation" (2007) 74(3) *Antitrust Law Journal* 575 578.
[148] RJR Pertiz "Dynamic Efficiency and US Antitrust Policy" in A Cucinotta, R Pardolesi & R. van den Bergh (eds) *Post-Chicago Developments in Antitrust Law* (2002) 108 114.
[149] M Dodgson & D Gann *Innovation: A Very Short Introduction* (2010) 20.
[150] AI Gavil & H First *The Microsoft Antitrust Cases: Competition Policy for the Twenty-first Century* (2014) 312.

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4 3 Evolution of statutory competition law

4 3 1 Introduction

Since statutory competition law has its origin in the United States, it is most appropriate to start the discussion on this topic with a reference to an important dictum by the United States Supreme Court.

> "Antitrust laws in general, and the Sherman Act in particular, are the Magna Charta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete- to assert with vigour, imagination, devotion, and ingenuity whatever economic muscle it can muster."[151]

This statement by the United States Supreme Court, even though it was made in the context of that country, stresses the importance of having competition law in every modern society. It signifies the most fundamental principles on which competition is based namely economic freedom, free enterprise, the freedom of enterprises to compete, efficient allocation of economic resources, low prices and high quality products and services. In order to apply competition policy to businesses, there needs to be competitive relations between businesses.

The United States antitrust law, together with the EU competition law, undoubtedly are the two most influential competition law systems. These two regimes are influential because many countries have introduced competition laws based on either the United States' or the EU's competition law regimes or a combination of rules found in both regimes. These two competition law regimes have had an enormous impact on scholars, politicians, officials who envisage better competition policies for their own countries and practitioners who use the learning from these systems when they deal with cases in their own systems. Hence it is necessary to scrutinize the

[151] *United States v Topco Associates Inc* 405 U.S. 596 (1972) 610. See also M Brassey *Competition Law* (2002) 3.

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evolution of these two competition law regimes. In a South African context it is important, firstly, because South Africa's competition laws have also been greatly influenced by these two competition law regimes. Secondly, the EU has the only state aid control regime which forms part of its statutory competition laws and its state aid control regime serves as a benchmark for the recommendations in chapter 5 regarding South African SOEs and state aid control.

4 3 2 Statutory Competition law (antitrust law) in the United States

American antitrust law, even though a creation of statute, has its roots in the (English) Common law restraint of trade doctrine[152] and the common law tort of unfair competition.[153] According to Fox American antitrust law is based on four "ancestral pillars" which were established by English case law and forms the basis for free market competition policy in America. These are that (i) state-granted monopoly is bad, (ii) cartels harm the public good, (iii) free entry into markets is good, and no incumbent competitor should be able to sue for the private loss that new entry entails since no one can sue for harm from competition itself and (iv) some private restraints are necessary to facilitate salutary transactions, and reasonable restraints are desirable and permissible.[154]

Fox further states that these principles are the "basic guarantors" of economic freedom in America. Therefore, according to Fox, American antitrust law is all about economic freedom, with efficiency only being a "by-product" of such freedom.[155] Today these four principles are not only reflected in the antitrust laws of the United States but also in the competition laws of many of those countries which adopted their own competition law regimes.

[152] P Sutherland & K Kemp *Competition Law of South Africa* (2014) 2-13.
[153] DF Broder *A Guide to US Antitrust Law* (2005) 28. See also DF Broder *U.S. Antitrust Law and Enforcement: A Practice Introduction* (2012) 2.
[154] EM Fox "The Sherman Antitrust Act and the World- Let Freedom Ring" (1990) 59(1) *Antitrust Law Journal* 109 109.
[155] EM Fox "The Sherman Antitrust Act and the World- Let Freedom Ring" (1990) 59 (1) *Antitrust Law Journal* 109 113.

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Antitrust law in the United States is mostly addressed on a federal level[156] even though many federal states have also passed their own antitrust laws which are enforced by the attorneys general of the states.[157] The key antitrust laws in the United States are the Sherman Act (15 U.S.C. Sections 1 - 11), the Clayton Act (15 U.S.C. Sections 12-27) and the Federal Trade Commission Act (15 U.S.C. Sections 41-58).[158] Although many changes have been made to these statutes since their inception, the basic principles remain the same.[159] Other statutes governing "marketplace competition" include the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (15 U.S.C. Section 18a, as amended)[160], the International Antitrust Enforcement Assistance Act of 1994 (15 U.S.C. Sections 46, 57b-1, 1311, 1312, 6201, 6201 note, 6202-6212)[161] and the Robinson-Patman Act of 1936 (which amended the Clayton Act and which is codified in 15 U.S.C. Sections 13, 13a,13b and 21(a)[162]. The Antitrust Division of the United States Department of Justice and the Federal Trade Commission are the authorities responsible for the enforcement of the antitrust laws.[163]

4 3 2 1 The Sherman Act of 1890

> "The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the

[156] F Alese *Federal Anti-trust and EC Competition Analysis* (2008) 1.
[157] DF Broder *A Guide to US Antitrust Law* (2005) 29.
[158] See the following agreement: Federal Republic of Germany- United States: Agreement Relating, to Mutual Cooperation Regarding Restrictive Business Practices (1976) 15(6) *International Legal Materials* 1282 1282
[159] See H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2005) 2.
[160] This Act authorises the Federal Trade Commission and the Department of Justice's Antitrust Division to pre-screen mergers and acquisitions for possible antitrust violations. The Act requires that individuals or corporations with specified minimum assets or annual turnover must report all acquisition of assets or voting rights if such acquisition is above a specified amount. See DF Broder *U.S. Antitrust Law and Enforcement: A Practice Introduction* (2012) 22.
[161] This Act provides for cooperation between the United States and foreign countries to improve international antitrust enforcement. It also makes provision for the United States to enter into mutual agreements with foreign countries for assistance in a wide variety of antitrust matters. The United State has entered into many such agreements with foreign countries. See DF Broder *U.S. Antitrust Law and Enforcement: A Practice Introduction* (2012) 23.
[162] This Act prohibits price discrimination and predatory pricing. See DF Broder *U.S. Antitrust Law and Enforcement: A Practice Introduction* (2012) 23.
[163] See the following agreement: Federal Republic of Germany- United States: Agreement Relating, to Mutual Cooperation Regarding Restrictive Business Practices (1976) 15(6) *International Legal Materials* 1282 1282.

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> premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conductive to the preservation of our democratic political and social institutions."[164]

The Sherman Act forms the foundation of antitrust law in America. The last three decades of the nineteen century saw a thriving American economy. Not only was this positive outlook of the American economy good for firms, but firms also became the most valuable "economic institutions" and this led to a dramatic expansion of the industrial sector.[165] The American people were in favour of the expanded industrial sector and fully supported "corporate America" and its industrialization ambition.[166] Since so many firms existed and supported the American industrialization ambition before the enactment of the Sherman Act, the amount of firms was thus not considered to be problematic.[167] What was indeed troublesome was the size of certain firms and the lack of competition among these firms.[168] It is stated that "aggressive industrialists" were building their business empires without any regard for other market players such as farmers, buyers and other small players.[169] Individuals like JP Morgan and JD Rockefeller were considered to be the "personification of the consolidation of power".[170] Competition was not a priority among the business leaders in charge of the big corporations. Various negative meanings were attributed to competition. Some of these include reference to competition as "industrial war", that "[i]gnorant, unrestricted competition, carried to its logical conclusion, means death to some of the combatants and injury to all" and that not even competitors who came out on top after such an "industrial war", and did not cease to exist, were spared the harm of such competitive "combat".[171] Unrestricted

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[164] *Northern Pacific Railway Company v United S*tates of America 356 U.S. 1 4 78 S. Ct. 514 (1958) 517.
[165] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 56.
[166] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 56.
[167] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 56.
[168] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 56.
[169] See EM Fox "When the State Harms Competition – the Role for Competition Law" (2014) 79 (3) *Antitrust Law Journal* 769 769-820.
[170] J Conlin *The American Past: A Survey of American History Since 1865,Vol. II* (2010) 451.
[171] These were the views held on competition among executive members of some of the biggest American corporations quoted in various sources. See T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 57 and D F Noble *Beyond the Promised Land: The Movement and the Myth, Between the Lines Books* (2005) 125.

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competition was also seen as a "deceptive mirage" and the idea of rational cooperation was considered to be "natural" instead of "cutthroat competition".[172]

At first, pricing policies were being used to destroy rival businesses.[173] However, businesses which used such pricing tactics did not necessarily become more profitable.[174] Consequently, firms started to combine, first through "pools"[175] and then "trusts".[176] By the 1880s "pool arrangements" between firms were common[177] and the number of trusts grew as well.[178] Such combinations led to the increase of big businesses which obtained market power[179] to control whole industries and big business just became bigger.[180]

However, even though common, such "pool arrangements" amongst railroads soon were outlawed by the Interstate Commerce Act due to governmental and customer disapproval.[181] Trusts[182] on the other hand, unlike other forms of business organization which were used in America during the later years of the nineteen century, were considered to be the one business form which created the most concern among members of the public.[183] They were considered a "menace" to

[172] DB Audretsch *The Entrepreneurial Society* (2007) 38.
[173] JR Williamson *Federal Antitrust Policy during the Kennedy-Johnson Years* (1995) 1. See also T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 58.
[174] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 58.
[175] Also referred to as "loose agreements". See JR Williamson *Federal Antitrust Policy during the Kennedy-Johnson Years* (1995) 1.
[176] Also referred to as "tight agreements". See JR Williamson *Federal Antitrust Policy during the Kennedy-Johnson Years* (1995) 1.
[177] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 58.
[178] J Conlin *The American Past: A Survey of American History Since 1865, Vol. II* (2010) 451.
[179] See WM Landes & RA Posner "Market Power in Antitrust Cases" (1981) 94 (5) *Harvard Law Review* 937. 937 where the authors describes the term "market power". Market power "refers to the ability of a firm (or a group of firms, acting jointly) to raise price above the competitive level without losing so many sales so rapidly that the price increase is unprofitable and must be rescinded." The standard of proving market power in antitrust case, according to the authors, is by "first defining a relevant market in which to compute the defendant's market share, next computing that share, and then deciding whether it is large enough to support an inference of the required degree of market power."
[180] J Conlin *The American Past: A Survey of American History Since 1865, Vol. II* (2010) 451.
[181] T McNeese *The Robber Barons and the Sherman Antitrust Act: Reshaping American Business* (2009) 58.
[182] Trusts were at one point described as "conspiracies that restrained interstate and foreign trade". See A. Axelrod & C Phillips *What Every American Should Know About American History: 225 Events that Shaped the Nation* (2008) 183.
[183] JL Baumgardner "Sherman Antitrust Act" in L C Schlup & JG Ryan (eds) *Historical Dictionary of the Gilded Age* (2003) 448 448.

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consumer welfare that was "designed to curtail competition".[184] During the 1880s the American public realised that "combination" of businesses reduced the number of competitors and in some instances led to monopolies.[185] "Combinations" at times tended to achieve exactly the opposite of fair competition and with each "combination" the level of competition was reduced.[186] Since there was little competition for some trusts, they did not feel the need to price products competitively and consequently product prices were inflated, which led to huge profits for these trusts.[187]

It seems though that not everything about "combinations" was bad. Letwin observes that just as competition was good, combinations also had good elements. According to the author combinations created efficient businesses and the efficiency of such businesses reduced the cost of goods which again reflected in "people's income", while competition kept down the prices of goods.[188] This according to Letwin caused quite a dilemma for the American legislatures when the Sherman Act had to be drafted.[189] Even though "combinations" in some cases had some positive results, such as efficiency, it also led to big businesses which sometimes abused their market power. It was therefore decided that when "combinations" would lead to monopolies, it should be prohibited.[190] Trust and other "combinations" which had the potential to limit or eliminate competition thus had to be outlawed and the Sherman Act[191] was the legislation which would ultimately do that. The big "evil" which the Sherman Act had to address was the big trusts, "which could swallow up or drive out smaller businesses and charge monopoly prices."[192]

On 2 July 1990 the United States celebrated the centenary of the Sherman Act. It became the first statute in America to control big business. The Sherman Act was

[184] JL Baumgardner "Sherman Antitrust Act" in LC Schlup & JG Ryan *Historical Dictionary of the Gilded Age* (2003) 448 448.
[185] W Letwin *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (1956) 9.
[186] W Letwin *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (1956) 9.
[187] See A Axelrod & C Phillips *What Every American Should Know About American History: 225 Events that Shaped the Nation* (2008) 183.
[188] W Letwin *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (1956) 10.
For a similar observation see also H Hovenkamp *The Antitrust Enterprise: Principle and Execution* (2008) 42.
[189] W Letwin *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (1956) 10.
[190] W Letwin *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (1956) 10.
[191] This Act can be found in the United States Code Title 15 Chapter 1.
[192] See *Henry v Chloride Inc.* 809 F.2d 1334 C.A.8 (Mo.) (1987) 1139.

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enacted in 1890 after it was submitted to the Senate in 1888 by Senator John Sherman,[193] who is the "founding father of the Republican Party in Ohio".[194] The act gets described as the first statute to control big companies and to protect small businesses.[195] It is stated that the act was a result of many years of public protest against the abuse of power by big businesses.[196] It was intended to lead to fair competition, to provide all companies including the small ones the chance to succeed.[197] It was also intended to prohibit practices which could eliminate competition.[198]

In 1911 Justice White, the then Chief Justice of the Supreme Court, stated in *Standard Oil Company of New Jersey v U.S*.[199] that Congressional debates at the passage of the Sherman Act conclusively show that the main reason for the legislation was the economic conditions at the time. The court observed that these economic conditions led to (i) a vast accumulation of wealth in the hands of corporations and individuals, (ii) an enormous development of corporate organization, (iii) the facility for combination which such organizations afforded, (iv) that the possibilities to combine was being used by the corporations and consequently combinations known as trusts multiplied and (v) the widespread impression that the power of these trusts had been and would be exerted to oppress individuals and injure the public generally. Even though Congressional debates cannot be used to interpret a statute, such debates are however important to ascertain "the environment" at the time the Act was enacted.[200] Few prosecutions

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[193] RJR Peritz *Competition Policy in America: History, Rhetoric, Law: History, Rhetoric, Law* (1996) 5.
[194] L Schlup "John Sherman" in LC Schlup & JG Ryan *Historical Dictionary of the Gilded Age* (2003) 448 448.
[195] H Cefrey *The Sherman Antitrust Act: Getting Big Business Under Control* (2004) 4.
[196] H Cefrey *The Sherman Antitrust Act: Getting Big Business Under Control* (2004) 7.
[197] H Cefrey *The Sherman Antitrust Act: Getting Big Business Under Control* (2004) 5.
[198] W Letwin *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act* (1956) 3.
[199] 221 U.S.1 (1911) 50.
[200] *Standard Oil Company of New Jersey v U.S.* 221 U.S.1 (1911) 50. This observation is shared in other cases by the United States Supreme Court and other federal court such as *in U.S. v Trans-Missouri Freight Association* 166 U.S. 290 (1897) 317-319 where the court stated that "it is impossible to determine with certainty what construction was put upon an act by the members of a legislative body that passed it by resorting to the speeches of individual members thereof. Those who did not speak may not have agreed with those who did, and those who spoke might differ from each other; the result being that the only proper way to construe a legislative act is from the language used in the act, and, upon occasion, by a resort to the history of the times when it was passed."
US v Union Pacific Railroad Company 91 U.S. 72 (1875) 79 where the Supreme Court said that: "In construing an act of Congress, we are not at liberty to recur to the views of individual members in debate, nor to consider the motives which influenced them to vote for or against its passage. The act itself speaks the will of Congress,

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were instituted by the government during the first ten years of the Sherman Act.[201] Not only was it an unknown field to Congress but both Democrat and Republican administrations at the time were considered to be "friendly to big business".[202] Consequently, even with the Sherman Act in place business combinations continued unabated.[203] This however changed in 1901 when Theodore Roosevelt became the American President. When Roosevelt realised how unpopular big business was among the American people, he decided to make "trust-busting" part of the focus of his administration.[204] Roosevelt became known as the "trustbuster".[205] He took a strong stance against the power of business combinations[206] and was determined to break-up the "onerous and flagrant monopolies and trusts."[207] The Roosevelt administration started to enforce the Sherman Act actively. Voters (consumer, workers and small business owners) were supportive of Roosevelt's "antitrust initiatives".[208] Roosevelt broke up trusts throughout his presidency, which was from

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and this is to be ascertained from the language used. But courts, in construing a statute, may with propriety recur to the history of the times when it was passed; and this is frequently necessary, in order to ascertain the reason as well as the meaning of particular provisions in it." And *Mitchell v Great Work Milling and Manufacturing Company 2 Story* 648, 17 F.Cas. 496 (C.C.Me. 1843) 498-499 where the court said that*:* "What passes in congress upon the discussion of a bill can hardly become a matter of strict judicial inquiry; and if it were, it could scarcely be affirmed, that the opinions of a few members, expressed either way, are to be considered as the judgment of the whole house, or even of a majority. But, in truth, little reliance can or ought to be place upon such sources of interpretation of a statute. We are bound to interpret the act as we find it, and to make such an interpretation as its language and its apparent objects require. We must take it to be true, that the legislature intend precisely what they say, and to the extent which the provisions of the act require, for the purpose of securing their just operation and effect. Any other course would deliver over the court to interminable doubts and difficulties; and we should be compelled to guess what was the law, from the loose commentaries of different debates, instead of the precise enactments of the statute."

[201] The first cases under the Sherman Act include *United States v Jellico Mountain Coal & Coke Co.,* 43 Fed. 898 (1890), 46 Fed. 432 (C.C.M.D. Tenn. 1891). a case against various coal producers and dealers which alleged a combination which was formed for the purpose of fixing wholesale and retail prices of coal*; United States v. Trans-Missouri Freight Association* 166 U.S. 290, 17 S.Ct. 540 U.S. (1897), a case against the Trans-Missouri Freight Association, an association of railroads, which alleged a combination formed for the purpose of fixing rates for freight traffic*; United States v Benjamin F. Nelson* 52 F. 646 (D.C. Minn. 1892), a case against certain lumber dealers, who had an agreement to raise the retail price of lumber and *United States v E. C. Knight Co*. (1892) a case against the E. C. Knight Company and other sugar producers, alleging that the American Sugar Refining Company had acquired control of a large majority of all the sugar refineries in the United States and, in order to obtain complete control of the price of sugar in the United States, had entered into an unlawful scheme to purchase the stock, machinery, and real estate of the other producers.

[202] J Conlin *The American Past: A Survey of American History, Vol. II* (2010) 451.

[203] J Conlin *The American Past: A Survey of American History, Vol. II* (2010) 451.

[204] H Brogan *History of the United States of America* (1985) 464.

[205] M Winerman "The Origins of the FTC: Concentration, Cooperation, Control, and Competition" (2003) 71(1) *Antitrust Law Journal* 1 16.

[206] JF Rill & SL Turner "Presidents Practising Antitrust: Where To Draw The Line?" (2014) 79 (2) *Antitrust Law Journal* 577 578.

[207] T Lansford *Theodore Roosevelt in Perspective* (2005) 77.

[208] T Lansford *Theodore Roosevelt in Perspective* (2005) 76.

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1901 until 1909.[209] He is credited with the creation of an antitrust unit within the Department of Justice even though the Antitrust Division as it is known today was created in 1933 by President Franklin D Roosevelt.[210] After Theodore Roosevelt left office in 1909, his successor, William Taft, continued Roosevelt's "trustbusting" policies.[211] Taft initiated even more anti-trust proceedings than Roosevelt did during his administration and it was Taft's administration which broke up the giant Standard Oil Company.[212]

Roosevelt's active stance against "bad" trusts[213] led to more court cases.[214] This again increased the number of authoritative judicial interpretations of the provisions of the Sherman Act by the courts.

The important provisions of the Sherman Act provide as follows:

Section 1: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a

[209] See A Axelrod & C Phillips *What Every American Should Know About American History: 225 Events that Shaped the Nation* (2008) 184. See also JF Rill & SL Turner "Presidents Practising Antitrust: Where to Drawthe Line?" (2014) 79(2) *Antitrust Law Journal* 577 578.
[210] M Winerman "The Origins of the FTC: Concentration, Cooperation, Control, and Competition (2003) 71(1) *Antitrust Law Journal* 1 17.
[211] See A Axelrod & C Phillips *What Every American Should Know About American History: 225 Events that Shaped the Nation* (2008) 184. See also T Lansford *Theodore Roosevelt in Perspective* (2005) 77.
[212] See *Standard Oil Co. of New Jersey v U.S.* 221 U.S. 1 (1911). See also H Brogan *History of the United States of America* (1985) 468.
[213] See T Lansford *Theodore Roosevelt in Perspective* (2005) 77 where the author states that Roosevelt believed that there were "good" and "bad" trusts. A "good" trust was seen as efficient, which was the result of "natural progression of market forces" and it added to economic growth and kept prices low while "bad" trusts exploited consumers by driving prices up and rivals out of business and also through monopoly deprived the consumers of choices.
[214] The first case which reached the Supreme Court during Roosevelt's administration as a result of his administration's active enforcement of the Sherman Act against trusts was *Northern Securities Co. v U.S.* 193 U.S. 197 (1904) , a case against the Northern Securities Company and other individuals, for a violation of Section 1 of the Sherman Act. It was alleged that in terms of an agreement in restraint of trade Northern Securities Company had acquired and held a large majority of the stock of the Great Northern Railway Company and Northern Pacific Railway Company, which were competitors. The combination was declared illegal and the Northern Securities Company was prohibited from acquiring any more stock in the two railway companies and from exercising any control over the two railway companies.

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corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court."[215]

Section 2: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court."[216]

Voorhees states that the particular Congress at the time, which was responsible for enacting the Sherman Act, did not provide any statutory definitions for terms such as "restraint of trade" and "monopolization" and no other Congress has done it since then.[217] As a result the interpretation of the wording of these two sections has been left largely to the federal courts. Although the courts initially found it difficult to apply the act,[218] today however, various interpretations of the sections of the Sherman Act exist and Voorhees calls it "court-made antitrust jurisprudence".[219] Some cases of the United States Supreme Court on the Sherman Act provide guidance on the interpretation of the two important provisions of the Act.[220]

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[215] United States Code, Title 15- Commerce and Trade. Chapter 1- Monopolies and Combinations in Restraint of Trade, Section 1-Trusts, etc., in restraint of trade illegal; penalty.

[216] United States Code, Title 15- Commerce and Trade. Chapter 1-Monopolies and Combinations in Restraint of Trade, Section 2. Monopolizing trade a felony; penalty.

[217] T Voorhees.Jr "The Political Hand in American Antitrust- Invisible, Inspirational, or Imaginary? (2014) 79 (2) *Antitrust Law Journal* 557 560.

[218] See A Axelrod & C Phillips *What Every American Should Know About American History: 225 Events that Shaped the Nation* (2008) 183.

[219] T Voorhees.Jr "The Political Hand in American Antitrust- Invisible, Inspirational, or Imaginary? (2014) 79(2) *Antitrust Law Journal* 557 560.

[220] Such cases include *U.S. v Trans-Missouri Freight Association* 221 U.S. 1. (1911) 312 when the court stated that "The language of the act includes every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states or with foreign nations. So far as the very terms of the statute go, they apply to any contract of the nature described. A contract, therefore, that is in restraint of trade or commerce is, by the strict language of the act, prohibited."

Standard Oil Co. of New Jersey v U.S. 166 U.S. 290 (1897) 60-61 made observation in regarding the interpretation of both section 1 and 2 of the Sherman Act.

In regard to section 1 of the statute the court said: "That in view of the many new forms of contracts and combinations which were being evolved from existing economic conditions, it was deemed essential by an all-embracing enumeration to make sure that no form of contract or combination by which an undue restraint of interstate or foreign commerce was brought about could save such restraint from condemnation. The statute under this view evidenced the intent not to restrain the right to make and enforce contracts, whether resulting from combinations or otherwise, which did not unduly restrain interstate or foreign commerce, but to protect

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Different interpretations by the courts give rise to the question as to what Congress's initial goals were with the enactment of the Sherman Act. According to Hofstadter antitrust traditionally had three classes of goals and these are economic, political as well as social and moral goals.[221] However, the predominant view today in the antitrust community is that the antitrust laws were passed to ensure economic efficiency.[222] Although the Sherman Act is more than hundred years old, debates are still raging as to its original goals.[223]

The work of scholars such as Robert H. Lande and Richard Bork had a profound impact on how the courts interpreted the Sherman Act. Lande believed that the primary goal of the Sherman Act was to prohibit the "transfer of wealth away from consumers",[224] while Bork believed that economic efficiency was the primary goal of the Sherman Act.[225] It is however argued that Bork's initial observation was that the Sherman Act's main goal was consumer welfare and that he only changed this later,

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that commerce from being restrained by methods, whether old or new, which would constitute an interference,—that is, an undue restraint.
In regard to section 2 of the statute the court said: "And a consideration of the text of the 2d section serves to establish that it was intended to supplement the 1st, and to make sure that by no possible guise could the public policy embodied in the 1st section be frustrated or evaded. The prohibition of the 2d embrace 'every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize, any part of the trade or commerce among the several states or with foreign nations . . .' By reference to the terms of § 8 it is certain that the word 'person' clearly implies a corporation as well as an individual"

[221] R Hofstadter *The Paranoid Style in American Politics and Other Essays* (2008) 199-200.

[222] JB Kirkwood & RH Lande "The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency" 84(1) *Notre Dame Law Review* 191 192.

[223] AN Kleit "Common Law, Statute Law, And the Theory of Legislative Choice: An Inquiry into the Goal of the Sherman Act" (1993) 31 (4) *Economic Inquiry* 647 647.

[224] Lande's views found some support from Hovenkamp in H Hovenkamp "Antitrust Protected Classes" (1989) 88(1) *Michigan Law Review* 1 22 where the Hovenkamp states that:
"In 1966, Robert Bork attempted to show that Congress' dominant concern in passing the Sherman Act was allocative efficiency, neoclassically defined. According to Bork, wealth transfers from consumers to dominant firms were really not all that important as far as the Congress of 1890 was concerned. Neither was it concerned about injury to competitors. Congress' principal concern, Bork argued, was that monopoly would lower output and force consumers to make inefficient substitutions for the monopolized product. But Bork's analysis of the legislative history was strained, heavily governed by his own ideological agenda. He concluded all too quickly that because some members of Congress knew that demand curves slope downward (i.e., that output is reduced as prices rise), that they also had a modern conception of allocative efficiency and the social cost of monopoly. Not a single statement in the legislative history comes close to stating the conclusions that Bork drew."
Hovenkamp provides his own interpretation of the legislative history of the Sherman Act. The author is of the opinion that the 1890 Congress wanted to protect competition and since competition was not formally defined it was mostly seen by some members of the 1890 Congress as rivalry between sellers. Hovenkamp observes that competition was never about prices equalling marginal cost as such a theory did not form part of the economic literature at that time. See H Hovenkamp "Antitrust Protected Classes" (1989) 88(1) *Michigan Law Review* 1 23.

[225] AN Kleit "Common Law, Statute Law, And the Theory of Legislative Choice: An Inquiry into the Goal of the Sherman Act" (1993) 31(4) *Economic Inquiry* 647 647.

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a theory questioned by observers of Bork's work.[226] Crane states that Bork's most significant contribution to antitrust is that he identified economic efficiency as the sole objective of the United States' antitrust laws.[227]

Other scholars such as Pitofsky argues even while the "political forces" were different when the major antitrust laws were enacted, the laws were always meant to make economic considerations more important than non-economic considerations and that, at some time during the existence of antitrust laws, lawyers and economist have convinced courts to adopt a pure economic approach to antitrust law.[228]

Clearly two opposing positions existed and may still exits as to Congress' original goals when enacting the Sherman Act. On the one hand there are those who believe that the Sherman Act initially had both "non-economic" and "economic" goals and on the other hand those who believe that the Sherman Act had only "economic" goals when it was enacted. The question thus arises as to which one of these two views was favoured by the courts in particular the United States Supreme Court. Did the courts tend to interpret the Sherman Act in order to give effect to the consumer welfare principle or were the court more incline to interpret the Sherman Act to ensure economic efficiency is the trumping principle? It is apparent that the Supreme Court in every case which was before it after the passage of the Sherman Act considered the "legal situation" at the time of its passage in order to determine whether there was an infringement of the act or not.

[226] See DA Crane "The Tempting of Antitrust: Robert Bork and the Goals of Antitrust Policy" (2014) 79(3) *Antitrust Law Journal* 835 835-836. Crane states that: "Bork did not, as is often argued, begin by defining the purposes of antitrust law as consumer welfare and then magically turn consumer welfare into allocative efficiency. From the beginning of his argument, he asserted that consumer welfare and efficiency went hand in hand -that the consumer interest was in efficiency. Indeed, much of his argument that Congress intended to benefit consumers began with proof that the antitrust statutes were intended to promote efficiency, from which Bork derived that Congress meant to benefit consumers. Hence, far from starting with consumers and ending with efficiency, Bork started with both efficiency and consumers."

[227] DA Crane "The Tempting of Antitrust: Robert Bork and the Goals of Antitrust Policy" (2014) 79(3) *Antitrust Law Journal* 835 835-836.

[228] R Pitofsky "The Political Content of Antitrust" (1979) 127(4) *University of Pennsylvania Law Review* 1051 1051.

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The case of *United States v Trans-Missouri Freight Association*[229] was the first major case which represented the "first judicial debate" about the goals of the Sherman Act and how the act was to be interpreted.[230] Justice Peckham[231] stated that the goals of the Sherman Act cannot just be determined by looking at the debates which took place amongst Congress members at the time of the passing of the Act[232] but that the court has the responsibility to determine the meaning of the Sherman Act just like with any other statute. The meaning of the provisions of the Sherman Act as stated today in literature is thus attributed to the federal courts and its interpretation of the act.

Many cases[233] which referred to the goals of the Sherman Act followed but economic analysis was not necessarily always the guiding principle in these cases. *U.S. v Arnold Schwinn & Co*.[234] was one of those case in which the court "explicitly rejected economic reasoning."[235] Muris states that the *Schwinn* decision was heavily criticised and that the court seemed to have been "simply confused".[236] This so-called confusion by the courts as to the goals of the Sherman Act prompted Robert Bork, a prominent legal antitrust legal scholar, to look into the legislative intent of the Sherman Act since the courts "were freely choosing among multiple, incommensurable, and often conflicting values."[237] In one of his most famous

[229] *United States v Trans-Missouri Freight Association* 166 U.S. 290 (1897). It was a case against the Trans-Missouri Freight Association, an association composed of railroads operators, alleging a combination formed for the purpose of fixing uniform rates, rules, and regulations for all freight traffic. The US government was initially unsuccessful in the lower courts, however the Supreme Court overturned the lower courts' decisions and confirmed a contravention of the Sherman Act.

[230] JE Hartley *The Rule of Reason* (1999) 34.

[231] See *United States v Trans-Missouri Freight Association* 166 U.S. 290 (1897) 318.

[232] See 166 U.S. 290 (1897) 318 where the Justice observed that:
"Looking simply at the history of the bill [which became the Sherman Act] from the time it was introduced in the senate until it was finally passed, it would be impossible to say what were the views of a majority of the members of each house in relation to the meaning of the act. All that can be determined from the debates and reports is that various members had various views, and we are left to determine the meaning of this act, as we determine the meaning of other acts, from the language used therein. There is, too, a general acquiescence in the doctrine that debates in congress are not appropriate sources of information from which to discover the meaning of the language of a statute passed by that body."

[233] See for example *Fashion Originators' Guild of America v Federal Trade Commission* 312 U.S. 457 (1941); *U. S. v Arnold Schwinn & Co*. 388 U.S. 365 (1967).

[234] 388 U.S. 365 (1967).

[235] TJ Muris "GTE Sylvania and the Empirical Foundations of Antitrust" (2001) 68 *Antitrust Law Journal* 899 900.

[236] TJ Muris "GTE Sylvania and the Empirical Foundations of Antitrust" (2001) 68 *Antitrust Law Journal* 899 900.

[237] DH Ginsburg "Bork's Legislative Intent" and the Courts" (2014) 79 (3) *Antitrust Law Journal* 941 950.

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articles[238] Bork draws the conclusion that the goal of the Sherman Act was to ensure efficiency and that this is clear from senator Sherman's emphasise that this bill (which became the Sherman Act) would not interfere with efficiency.[239] Bork states that "[not] once did Sherman suggest that courts should blunt or discourage efficient size or conduct in the interest of any social or political value."[240] In 1977 the US Supreme Court started to lean towards Bork's theory,[241] which is described as "one of his many enduring contributions to U.S. antitrust law."[242] It did so regardless of all the criticisms Bork's theory received.[243] It rejected the explicit rejection of economic reasoning in the *Schwinn* decision.[244] In *Continental T. V. Inc v GTE Sylvania Inc*.[245] the court stated:

> Such restrictions [vertical restrictions], in varying forms, are widely used in our free market economy….there is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary.[28] Certainly, there has been no showing in this case, either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a "pernicious effect on competition" or that they "lack . . . any redeeming virtue." Accordingly, we conclude that the per se rule stated in Schwinn must be overruled.[30] In so holding we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition under Northern Pac. R. Co. But we do make clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than as in Schwinn upon formalistic line drawing."[246]

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[238] See RH Bork "Legislative Intent and the Policy of the Sherman Act" (1966) 9 *Journal of Law and Economics* 7-48.
[239] RH Bork "Legislative Intent and the Policy of the Sherman Act" (1966) 9 *Journal of Law and Economics* 7 26.
[240] RH Bork "Legislative Intent and the Policy of the Sherman Act" (1966) 9 *Journal of Law and Economics* 7 27.
[241] DH Ginsburg "Bork's Legislative Intent" and the Courts" (2014) 79 (3) *Antitrust Law Journal* 941 941-942.
[242] DH Ginsburg "Bork's Legislative Intent" and the Courts" (2014) 79 (3) *Antitrust Law Journal* 941 949.
[243] For such criticism see for example JB Kirkwood & RH Lande "The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency" (2008) 84 *Notre Dame Law Review* 191- 243; and H Hovenkamp "Antitrust's Protected Classes" (1989) 88 *Michigan Law Review* 1-48.
[244] TJ Muris "GTE Sylvania and the Empirical Foundations of Antitrust" (2001) 68 *Antitrust Law Journal* 899 900.
[245] 433 U.S. 36 (1977).
[246] *Continental T. V. Inc v GTE Sylvania Inc*. 433 U.S. 36 (1977) 57–59.

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Through this U-turn in *Sylvania* the court actually returned to the earlier Sherman Act jurisprudence in cases such as *Northern Pacific Railway Company v US*[247] and *Appalachian Coals v US.*[248] This change of heart by the court necessitates a discussion of the two approaches that have been followed by the courts in regard to the interpretation of the provisions of the Sherman Act.

Two approaches regarding the interpretation of the provisions of the Sherman Act were developed, namely the "rule of reason" and the "per se illegal restraint of trade rule". In *State Oil Company v Khan*[249] the Supreme Court states that the provisions of the Sherman Act prohibits literally every restraint of trade[250] but that the court has for a long time recognized that Congress only outlawed "unreasonable restraints".[251] This led to the development of the "rule of reason". The Supreme Court described the "rule of reason" as follows:

> "Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition"[252]

The "rule of reason" was first recognised in 1911 by the Supreme Court in the case of *Standard Oil Company of New Jersey v United States*[253] It has ever since been

[247] 356 U.S. 1, 78 S.Ct. 514 U.S. (1958) 517 the court said that: "The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress."

[248] 288 U.S. 344 (1933) 359-360 the court stated that "The purpose of the Sherman Anti-Trust Act is to prevent undue restraints of interstate commerce, to maintain its appropriate freedom in the public interest, to afford protection from the subversive or coercive influences of monopolistic endeavor."

[249] 522 U.S. 3 (1997) 10.

[250] In *United States v Trans-Missouri Freight Association* 166 U.S. 290(1897) the court still strictly applied the provisions of the Sherman Act however in *United States v Joint-Traffic Association* 171 U.S. 505(1898) the court started to recognise that it was not the intention of the Congress to include "every" restraint of trade within the Sherman Act's ambit. This was when the "Rule of Reason" became the guide to determine whether a restraint falls within the ambit of the Sherman Act and it has been the position since *Standard Oil Company of New Jersey v U.S.* 221 U.S. 1 (1911).

[251] See also *United States v Topco Associates Inc.* 405 U.S. 596 (1972) 606 when the Supreme Court said that the wording of the Sherman Act prohibits any combinations if it is in restraint of trade and if the provisions of the Act would be narrowly interpreted, many commercial contracts would be illegal. The court further stated that it was not Congress intention to prohibit all contracts and also not contract that might in the slightest way impact on trade and competition. And therefore the courts developed the rule of reason in regard to the interpretation of the Sherman Act.

[252] *Continental T. V. Inc. v GTE Sylvania Inc.* 433 U.S. (1977) 49.

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applied in regard to certain restraints of trade and has been considered as the "the prevailing standard of analysis". In terms of the "rule of reason" the court evaluates specific information about the industry in which the alleged restraint exists, the conditions in the industry before and after the restraint was imposed and the history, nature and effect of the restraint.[254] After all such considerations were taken into account and the conclusion is that the restraint is negatively affecting competition, only then will the court decide to declare it an infringement of the Sherman Act. The "rule of reason" thus removes the presumption of illegality of a restraint. The Supreme Court however has not been oblivious to the fact that using the "rule of reason" may prove to be quite a challenge. In *Arizona v Maricopa County Medical Soc.*[255] the court observed that the application of the "rule of reason" is costly and litigation to determine whether an agreement or practice falls foul of the Sherman Act can be, firstly, "extensive and complex", and secondly, that judges often lack the understanding of markets and behaviours within such markets to make confident decision on the effects of a practice on competition.[256]

Dating back to 1897,[257] the courts have therefore also applied a per se rule. The per se rule does not require courts to do extensive investigation into whether the

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[253] See *Standard Oil Company of New Jersey v United States* 221 U.S. 1 (1911) 63-64 where the court said that: "it is obvious that judgment must in every case be called into play in order to determine whether a particular act is embraced within the statutory classes, and whether, if the act is within such classes, its nature or effect causes it to be a restraint of trade within the intendment of the act to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute." Another case in which the court emphasise that reason should play a role in determining the legality of a restraint of trade is *Board of Trade of City of Chicago v United States* 246 U.S. 231, 38 S.Ct. 242 U.S. (1918) 244 where the court said: "But the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences."

[254] See *Hyland v Home Services of America, Inc.* 771 F.3d 310 C.A.6 (Ky. 2014) 317.

[255] 457 U.S. 332 (1982).

[256] *Arizona v Maricopa County Medical Soiety.* 457 U.S. 332 (1982) 343-344.

[257] It is stated that the "per se rule" was first recognised by the US Supreme Court in the case of *United States v Trans-Missouri Freight Association* 166 U.S. 290 (1897). See M Flinn, WB Snell, JA Parsons, F Poul & VA Weber "The Per Se Rule" (1969) 38 (4) *Antitrust Law Journal* 731 731. See also D L Beschle "'What, Never?

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behaviour complained of is contravening the antitrust laws. Certain agreements and practices are thus presumed to be illegal in terms of the antitrust legislation. In *Northern Pacific Railway Company v US*[258] the Supreme Court stated that certain agreements and practices should be presumed to be illegal without the need for any elaborate inquiry as to the harm caused by such agreements or practices or the business excuse for such behaviour due to its "*pernicious effect on competition and lack of any redeeming virtue"*. It further stated that a complicated and prolonged economic investigation into the history of the industry involved and other related industries in order to determine whether a restraint is illegal, is often "fruitless".[259] Restraints of trade which come within the ambit of the "per se rule" are those with such a "predictable and pernicious anticompetitive effect", or "such limited potential for procompetitive benefit", and therefore the need to consider any economic considerations is discarded and such agreements and practices are considered to be automatically unlawful.[260] These include agreements and practices such as price fixing,[261] division of markets,[262] group boycotts,[263] and tying arrangements.[264] An inquiry in terms of the per se rules should thus focus on whether the agreement or practice complained of, "facially appears to be one that would always or almost always tend to restrict competition and decrease output".[265] Even though certain agreements and practices are considered to be per se illegal, the Supreme Court has acknowledge that there is no "bright line" separating the "per se rule" from a "rule of reason" analysis and therefore an inquiry into market conditions may be required before the agreement or practice is presumed anticompetitive.[266] A "per se rule" inquiry should however not lead to the same "burdensome analysis" which is

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Well, Hardly Ever': Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust Illegality" (1987) 38 *Hastings Law Journal* 471 472 who supports this observation.

[258] 356 U.S. 1 (1958).

[259] 356 U.S. 1 (1958) 5.

[260] *State Oil Co. v Khan* 522 U.S. 3, 118(1997) 10.

[261] See for example *Albrecht v. Herald Co.* 390 U.S. 145 (1968) and *U.S. v Socony-Vacuum Oil Co*. 310 U.S. 150 (1940).

[262] See for example *U.S. v Addyston Pipe & Steel Co*. 85 F. 271 C.A.6 1898 and *Addyston Pipe & Steel Co. v U. S.* 175 U.S. 211 (1899).

[263] See for example *Fashion Originators' Guild of America v Federal Trade Commission* 312 U.S. 457 (1941).

[264] See *Arizona v Maricopa County Medical Soc.* 457 U.S. 332, 102 S.Ct. 2466 (1982) 344; *International Salt Co. v U.S.* 332 U.S. 392 (1947) and *Standard Oil Co. of California v United States* 337 U.S. 293 (1949).

[265] *Broadcast Music, Inc. v Columbia Broadcasting System, Inc.* 441 U.S. 1(1979) 19.

[266] *National Collegiate Athletics Association v Board of Regents of the University of Oklahoma and University of Georgia Athletic Association* 468 U.S. 85(1984) 104 (footnote 26). See also ABA Section of Antitrust Law, Antitrust Law Developments6th ed (2007) 48.

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required for a "rule of reason" analysis.[267] Beschle states that in the 1970s there was a serious rethinking of the application of the "per se rule".[268] Expansion of its application started to contract when the "rule of reason" started to be applied to categories of behaviour which were once per se illegal.[269] The per se rule's application to practices such as horizontal price fixing, resale price maintenance, horizontal market division and tying arrangements became to a certain degree less strict since the courts were willing to consider arguments about the particular behaviour.[270] And the courts were willing to only classify agreements and practices as per se illegal "after considerable experience with certain business relationships".[271]

In conclusion, even though the Congress of 1890 did not provide a clear statutory description of the important terms of the Sherman Antitrust Act, today there is no paucity of guidance from the federal court as to the meaning of the wording of the statute. Since its enactment more than hundred years ago, the court provided competent meanings to the provisions of the statute. And many other regulatory instruments have been introduced to compliment the Sherman Antitrust Act. It is thus necessary to examine how these other regulatory instruments supplements the Sherman Act in regulating competition.

4 3 2 2 The Clayton Act

> "[T]he Clayton Act, which is a part of the scheme of laws against unlawful restraints and monopolies, does not wait for its operation until monopolies have been created and restraints of trade established, but seeks to reach them in their incipiency and stop their growth."[272]

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[267] *Broadcast Music Inc. v Columbia Broadcasting System, Inc.* 441 U.S. 1(1979) 19 (footnote 33).
[268] DL Beschle "'What, Never? Well, Hardly Ever': Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust illegality" (1987) 38 *Hastings Law Journal* 471 484-485.
[269] DL Beschle "'What, Never? Well, Hardly Ever': Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust illegality" (1987) 38 *Hastings Law Journal* 471 484-485.
[270] DL Beschle "'What, Never? Well, Hardly Ever': Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust illegality" (1987) 38 *Hastings Law Journal* 471 484-490.
[271] See *United States v Topco Associates, Inc.* 405 U.S. 596 (1972).
[272] *Standard Oil Corporation v Federal Trade Commission* 282 F. 81, 86 (3d Cir. 1922) 86.

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Trusts were still created even after the passing of the Sherman Act. Even with the provisions of the Sherman Act giving the courts great powers to prevent violations and restraints of the act, the "greatest merger activity" of that time occurred from 1895-1904 after the Sherman Act came into effect in 1890.[273] The Sherman Act's method of dealing with monopolies after they were formed, was not used sufficiently and the rise of big business continued.[274] "Populist concerns" continued as it was believed that financial crises in 1902 and 1907-1908 were a result of attempts by businessmen to create monopolies.[275]

When Woodrow Wilson,[276] came to power he decided to enact supplemental antitrust legislation, to compliment the Sherman Act.[277] Wilson acknowledged that he was not against big business that had become big due to the skills and intelligence of businessmen.[278] His problem was however with arrangements (trusts) which were intended to eliminate competition[279] and at one point he drew the conclusion that "corporate consolidation" has gone too far.[280] Wilson preferred "legal regulation" over "executive regulation".[281] Consequently Wilson's intended legislation, the Clayton Act, which was enacted on 15 October 1914 prohibited specific type of conduct.[282]

Together with the Sherman Act, it is considered the primary regulatory instruments to govern antitrust in the United States. The Clayton Act is enforced by the Antitrust

[273] CD Ramírez & C Eigen-Zucchi "Understanding the Clayton Act of 1914: An Analysis of the Interest Group Hypothesis" (2001) 106(1-2) *Public Choice* 157 158.
[274] WS Holt *"*The Federal Trade Commission - Its History, Activities and Organization*"* (1922) 1 *History* 1 2.
[275] CD Ramírez & C Eigen-Zucchi "Understanding the Clayton Act of 1914: An Analysis of the Interest Group Hypothesis" (2001) 106 (1-2) *Public Choice* 157 158.
[276] He was the 23th American President.
[277] ET Sullivan "The Antitrust Division as a Regulatory Agency: An Enforcement Policy in Transition" (1986) 64 *Washington University Law Quarterly* 997 1010.
[278] See WE Brownlee "Wilson's Reform of Economic Structure: Progressive Liberalism and the Corporation" in J M Cooper Jr (ed) *Reconsidering Woodrow Wilson: Progressivism, Internationalism, War, and Peace* (2008) 57 73.
[279] See WE Brownlee "Wilson's Reform of Economic Structure: Progressive Liberalism and the Corporation" in J M Cooper Jr (ed) *Reconsidering Woodrow Wilson: Progressivism, Internationalism, War, and Peace* (2008) 57 73.
[280] See WE Brownlee "Wilson's Reform of Economic Structure: Progressive Liberalism and the Corporation" in J M Cooper Jr (ed) *Reconsidering Woodrow Wilson: Progressivism, Internationalism, War, and Peace* (2008) 57 73.
[281] See WE Brownlee "Wilson's Reform of Economic Structure: Progressive Liberalism and the Corporation" in J M Cooper Jr (ed) *Reconsidering Woodrow Wilson: Progressivism, Internationalism, War, and Peace* (2008) 57 73.
[282] ET Sullivan "The Antitrust Division as a Regulatory Agency: An Enforcement Policy in Transition" (1986) 64 *Washington University Law Quarterly* 997 1010.

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Division of the US Department of Justice[283] and the Federal Trade Commission.[284] It prohibits behaviour such as price discrimination,[285] tying arrangements[286] "interlocking directorates and officers"[287] and mergers or acquisitions by one corporation of stock of another if such acquisition may have the effect to substantially lessen competition or to tend to create a monopoly.[288] Unlike the Sherman Act the Clayton Act does not impose criminal sanctions for the contraventions of these provisions. Other matters governed by the Clayton Act include imputation of personal liability of directors and agents of a corporation should the corporation violate any "penal provision" of the antitrust laws[289] and the exemption of labour organizations

[283] 15 U.S.C. § 25.

[284] The Clayton Act is indirectly enforced by the FTC as contraventions of this Act will also be regarded as breaches of section 5 of the FTC Act but it is also directly enforced by the FTC in some respects. For example, Section 7 of the Clayton Act prohibits the acquisition by one corporation of the stock of another, if "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly" and in terms of Section 13(b) of the Federal Trade Commission Act, the Federal Trade Commission is empowered to file suit in the federal district courts and seek a preliminary injunction to prevent a merger pending a Federal Trade Commission administrative adjudication "whenever the Commission has reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act. See 15 U.S.C.A. § 18 and *Federal Trade Commission v Penn State Hershey Medical Centre*, 838 F.3d 327, 337 3d Cir. (2016).
For more on the Federal Trade Commission see the discussion below on the Federal Trade Commission Act.

[285] See 15 U.S.C. § 13 which determines that: "It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination."

[286] See Title 15 U.S.C. § 14. In *Northern Pacific Railway Company v U.S.* 356 U.S. 1 (1958) 5-6 the Supreme Court described a tying arrangement as an agreement by a party to sell a product to another party but only on the condition that the buyer also purchases another product, one which is tied to the purchase of the first product or the buyer at least has to agree that he will not purchase the additional product from any other supplier. The court stated that 'tying agreements" serve hardly any purpose beyond the suppression of competition. In *Jefferson Parish Hospital District No. 2 v Hyde* 466 U.S. 2 (1984)10-18 the Supreme Court however stated that every refusal to sell two products separately cannot be said to restrain competition and that cases by that court have concluded that the "essential characteristic of an invalid tying arrangement" lies, firstly, in the seller's exploitation of its control over the tying product, secondly, to force the buyer into the purchase of the tied product that the buyer perhaps would not have bought or might have bought elsewhere, thirdly when such "forcing" is present, competition for the tied product is restrained. Thus an inquiry into the validity of a tying arrangement should focus on the market or markets in which the two products are sold as that is where the anticompetitive forcing has its impact. This last observation by the court is supported by DL Beschle, "What, Never? Well, Hardly Ever': Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust Illegality" (1987) 38 *Hastings Law Journal* 471 482 when the author states that the application of the per se rule of illegality in respect to tying arrangements has been applied differently in one respect namely that the tying arrangement is a per se violation only if the defendant has some sort of market power.

[287] See Title 15 U.S.C. § 19 which determines that no person shall serve as a director or officer in any two corporations at the same time which are competitors and has capital, surplus, and undivided profits aggregating more than $10,000,000 and that the elimination of competition through agreement between the two corporations would constitute a violation of the antitrust laws.

[288] See Title 15 U.S.C. § 18.

[289] See Title 15 U.S.C. § 24.

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from the application net of the antitrust laws.[290] The Act also provides that any person who suffers any injury to business or property[291] due to a violation of the antitrust laws may sue for threefold the damages sustained and the cost of the suit.[292] The year 2014 marked the centenary of the Clayton Act. Even though the Clayton Act has been amended on several occasions,[293] the basic provisions of the original Act remains intact and the modern version remains one of the strong antitrust laws.

[290] See Title 15 U.S.C. § 17 where it is stated that nothing within the antitrust laws forbid the existence and operation of such organizations and they are not to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws. This exemption to labour organization is however only afforded if the labour organization upheld the following two requirements as stated by the Supreme Court namely, that the union acts in its self-interest and does not combine with non-labor groups. See *U.S. v Hutcheson* 312 U.S. 219 (1941) 232

[291] See *Reiter v Sonotone Corporation* 442 U.S. 344 (1979). The Supreme Court provides clarity on how the term "business of property" should be interpreted to establish any economic harm.

[292] Section 7 of the Sherman Act originally made provision for treble damages for any harm suffered due to an antitrust violation. This section was later incorporated in the Clayton Act.

See 15 U.S.C.A. § 15 which states that. "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor [..], without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee."

The Supreme Court described the possibility to claim for treble damages as a "chief tool" in the enforcement of the antitrust law and as a deterrence to potential antitrust violators. See *Mitsubishi Motors Corporation v Soler Chrysler-Plymouth, Inc.* 473 U.S. 614 (1985*)* 634.

The goals of the treble damages provision, according to Cavanagh, include compensation of victims, deterrence of violators, forfeiture of ill-gotten gains and punishment for wrongdoing. See ED Cavanagh "Detrebling Antitrust Damages: An Idea Whose Time Has Come?" (1987) 61 *Tulane Law Review* 777 783. See also *Blue Shield of Virginia v. McCready* 457 U.S. 465 (1982) 471 where the Supreme Court stated that Congress' intention was to create a private enforcement mechanism which would deter antitrust violations and deprive any person who violates antitrust laws of the "fruits of their illegal actions" and for the victim to be compensated in a proper way.

The usefulness of treble damages as an antitrust enforcement tool has been question on many occasions by economists and legal scholars to the extent that a "detrebling movement" came into existence. It however remains an antitrust enforcement tool on the statute books. See ED Cavanagh "Detrebling Antitrust Damages: An Idea Whose Time Has Come?" (1987) 61 *Tulane Law Review* 777 777-848.

[293] The Robinson-Patman Act of 1936 amended the price discrimination provisions of the Clayton Act, the Hart-Scott-Rodino Antitrust Improvement Act of 1976, inter alia, introduced notification requirements for certain mergers and acquisitions and the 1950 amendment by the Celler-Kefauver Act was intended to " […] prevent economic concentration in the American economy by keeping a large number of small competitors in business" after large combinations continued to grow by using mergers since businessmen were circumventing Section 7 of the Clayton Act by purchasing their competitors' assets, as the section prohibited corporations under most circumstances from merging only by purchasing the stock of their competitors. See *U. S. v Von's Grocery Co*. 384 U.S. 270 (1966) 275.

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4 3 2 3 The Federal Trade Commission Act (FTC Act)

The FTC Act came into force in 1914. The Federal Trade Commission (the Commission)[294] enforces the FTC Act. The Commission was established as an independent institution.[295] The duties of the Commission, inter alia, include the prevention of unfair methods of competition and "to compile and investigate the economic facts concerning corporations engaged in interstate commerce"[296] even though it does not have "explicit statutory authority" to enforce the most important antitrust statute namely the Sherman Act.[297] The Commission was created to deal with "monopoly problems[298] and was the fulfilment of an election campaign promise of President Woodrow Wilson.[299]

Section 5 of the FTC Act deals with unfair methods of competition and unfair or deceptive acts or practices in commerce, which may have an effect on commerce.[300] Dahdouh argues that the Congress in 1914 was worried that the Sherman Act has put the enforcement of antitrust purely in the hands of the courts and that Congress did not want the courts to be the only enforcers of the antitrust laws.[301] Dahdouh further states that the antitrust laws at the time were too limited in scope.[302] As a consequence the Commission was created with its own power and jurisdiction to challenge anticompetitive conduct.[303] The Congress in 1914 intended section 5 to be an upgrade of the US antitrust system as the section was intended to have a wider reach over anti-competitive behaviour even beyond those which the Sherman and

[294] The Commission is a federal administrative agency tasked, inter alia, with the protection of consumers and competition.
[295] Its predecessor was the Bureau of Corporations.
[296] WS Holt "The Federal Trade Commission - Its History, Activities and Organization" (1922) 1 *History* 1 1.
[297] See H Hovenkamp "The Federal Trade Commission and the Sherman Act" (2010) 62 (4) *Florida Law Review* 871 872.
[298] RA Posner "The Federal Trade Commission" (1969) 37(1) *University of Chicago Law Review* 47 48.
[299] H Hovenkamp "The Federal Trade Commission and the Sherman Act" (2010) 62 *Florida Law Review* 871 871.
[300] See Title 15 U.S.C. § 45.
[301] See T Dahdouh "Section 5, the FTC and Its Critics: Just Who Are the Radicals Here?" (2011) 20 (2) *Journal of the Antitrust and Unfair Competition Law Section of the State Bar of California* 1 1-4.
[302] See T Dahdouh "Section 5, the FTC and Its Critics: Just Who Are the Radicals Here?" (2011) 20 (2) *Journal of the Antitrust and Unfair Competition Law Section of the State Bar of California* 1 1.
[303] See T Dahdouh "Section 5, the FTC and Its Critics: Just Who Are the Radicals Here?" (2011) 20 (2) *Journal of the Antitrust and Unfair Competition Law Section of the State Bar of California* 1 1.

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Clayton Acts encompass.[304] The scope of the section is thus wide enough to include conduct which may perhaps fall short of being anticompetitive under the Sherman or Clayton Acts,[305] as it may reach types of "competition harm" that are different from those that qualify as violations in terms of the Sherman and Clayton Acts.[306] However, it has in reality not been enforced or applied in a manner that extends beyond the Sherman and Clayton Acts.[307]

Kovacic and Winerman list five "principal motivations" that led to the enactment of section 5 by Congress:[308] firstly, the possibility that the Sherman Act, as applied by the courts would not encompass all trusts; secondly, Congress wanted to establish an "administration mechanism" which would ensure that the conduct of business stays within certain boundaries while taking into account evolving business practices and development; thirdly, to establish a body which would, among other things, investigate business conduct; fourthly, to create a "policy instrument" that would be independent from the executive authority; and lastly, to bring about a penalty regime different from the one in terms of the Sherman Act.[309]

Any unfair methods of competition and unfair or deceptive acts or practices in commerce or those which may affect commerce are unlawful in terms of the FTC Act.[310] With regard to the meaning of "unfair", the Supreme Court has stated that:

> The standard of "unfairness" under the FTC Act is, by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons."[311]

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[304] WE Kovacic & M. Winerman "Competition Policy and the Application of Section 5 of the Federal Trade Commission Act" (2010) 76(3) *Antitrust Law Journal* 929 930.
[305] See *Federal Trade Commission v. Cement Institute* 333 U.S. 683 (1948) 807.
[306] NW Averitt "The Elements of a Policy Statement on Section 5" (2013) 1 *Antitrust Source* 1 4.
[307] WE Kovacic & M. Winerman "Competition Policy and the Application of Section 5 of the Federal Trade Commission Act" (2010) 76 (3) *Antitrust Law Journal* 929 933.
[308] WE Kovacic & M. Winerman "Competition Policy and the Application of Section 5 of the Federal Trade Commission Act" (2010) 76 (3) *Antitrust Law Journal* 929 929-950.
[309] WE Kovacic & M Winerman "Competition Policy and the Application of Section 5 of the Federal Trade Commission Act" (2010) 76(3) *Antitrust Law Journal* 929 931.
[310] See 15 U.S.C.A. Section 45.
[311] See *Federal Trade Commission v Indiana Federation of Dentists* 476 U.S. 447 (1986) 454.

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The FTC Act empowers the Commission to prevent persons, partnerships and corporations, with the exception of certain business organisations specifically described in the FTC Act,[312] from using "unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce".[313] Any unfair method of competition which involves commerce with foreign nations, excluding import commerce, is not covered by the FTC Act outside of specifically circumscribed situations.[314]

There are several other statutes in the United States that concern competition on a federal or state level. The scope of this study however only covers the basic antitrust laws which are of importance and relevance for the analysis and examination of the hypothesis of this study.

4 3 3 Federal Antitrust laws and SOEs

> "For more than a hundred years corporations have been used as agencies for doing work of the government. Congress may create them 'as appropriate means of executing the powers of government"[315]

The "state acting as an owner" is not an unknown concept in the American economy. Field describes partial or full government ownership of a corporation as "an old American practice".[316] SOEs are known in America as "government corporations" or government-supported corporations which refers either to "mixed-ownership government corporations"[317] and/or wholly owned government corporations".[318]

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[312] See 15 U.S.C. Section 45 (a) (2) for these exceptions.
[313] 15 U.S.C. Section 45 (a) (2) for these exceptions.
[314] See 15 U.S.C. Section 45 (3) for these scenarios.
[315] *Keifer & Keifer v Reconstruction Finance Corporation* 306 U.S. 381 (1939) 389.
See also *Luxton v North River Bridge Co.* 153 U.S. 525 (1894) 529 where the court stated that Congress may create corporations as a means of executing the powers of government, like establishing a bank for the purpose of carrying on the fiscal operations of the United States or a railroad corporation for the purpose of promoting commerce among the states.
[316] OP Field "Government Corporations: Proposal" (1935) 48 *Harvard Law Review* 775 775.
[317] The following are examples of such corporations: the Central Bank for Cooperatives, the Federal Deposit Insurance Corporation, the Federal Home Loan Banks, the Federal Intermediate Credit Banks, the Federal Land

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Geddes states that "government corporations" in the United States compete with private firms in many industries which include transport, electricity supply, water works and mail delivery.[319]

Some of the best-known federal SOEs[320] are the National Railroad Passenger Corporation,[321] the United States Postal Service,[322] the Tennessee Valley Authority,[323] the Federal National Mortgage Association, also known as Fannie Mae and the Federal Home Loan Mortgage Corporation, also known as Freddie Mac.[324]

The antitrust laws apply to every contract or combination in the form of a trust or otherwise in restraint of trade and commerce and every person who monopolizes or attempts to monopolize commerce or trade in the United States.[325] There are however certain exemptions and exceptions from the application of the antitrust

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Banks, the National Credit Union Administration Central Liquidity Facility and the Regional Banks for Cooperatives. See Title 31 U.S.C. § 9101.

[318] See 31 U.S.C. § 9101 which deals with "Government Corporations". The following are examples of wholly owned government corporations: the Commodity Credit Corporation, the Community Development Financial Institutions Fund, the Export-Import Bank of the United States, the Federal Crop Insurance Corporation, Federal Prison Industries, Incorporated, the Corporation for National and Community Service, the Government National Mortgage Association, the Overseas Private Investment Corporation, the Pennsylvania Avenue Development Corporation, the Pension Benefit Guaranty Corporation, the Saint Lawrence Seaway Development Corporation, the Secretary of Housing and Urban Development when carrying out duties and powers related to the Federal Housing Administration Fund, the Tennessee Valley Authority.

[319] RR Geddes *Competing with the Government: Anticompetitive Behaviour and Public Enterprises* (2004) xi

[320] Refer to chapter 2 for a detailed discussion on SOEs.

[321] This corporation is described as a corporation established by the Congress in order to avert the threatened extinction of passenger trains in the United States. See *Lebron v National R.R. Passenger Corp.* 513 U.S. 374, (1995) 967.

[322] The US Postal Service started as an independent establishment of the executive branch of the Government of the United States. See 39 U.S.C. § 201. The functions of the US Post is stated as follows: "The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities." See 39 U.S.C. § 101. For more on the US Postal Service and its nature see also the case of *U.S. Postal Service v Flamingo Industries (USA) Ltd.* 540 U.S. 736 (2004) 748 where the Supreme Court stated that "The Postal Service, in both form and function, is not a separate antitrust person from the United States. It is part of the Government of the United States and so is not controlled by the antitrust laws."

[323] A government corporation which was established by the Tennessee Valley Authority Act of 1933, as amended and which gets described by the Supreme Court as "a federally owned corporation that operates fossil-fuel fired power plants in several States." See *American Electricity Power Company Inc. v Connecticut* 131 S.Ct. 2527 U.S. (2011) 2534.

[324] RR Geddes *Competing with the Government: Anticompetitive Behaviour and Public Enterprises* (2004) xi. See also *Garcia v. Federal National Mortgage Association* 782 F.3d 736 C.A.6 Mich. (2015) 737 where the United States Court of Appeals (sixth circuit) describes Fannie Mae and Freddie Mac as government-sponsored private enterprises that purchase and securitize residential mortgages. For further reading on these two government corporations see JR Hagerty *The Fateful History of Fannie Mae: New Deal Birth to Mortgage Crisis Fall* (2012).

[325] See Section 2 of the Sherman Act as discussed above in this chapter.

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laws. These include certain industries on a federal level and certain activities by states which may impact on competition.

4 3 4 SOEs on federal level: Possible exemption from the antitrust laws

> "…where the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of the First Amendment.[326]

In *City of Columbia v Omni Outdoor Advertising Inc*.[327] the Supreme Court stated that the Sherman Act prohibits the regulation of prices and goods in the marketplace by private persons but that this prohibition does not apply to those industries which Congress has exempted from the application of the antitrust laws. Immunity from antitrust laws can be found in many industries such as agriculture and transport. Sappington and Sidak are of the opinion that if a "federal SOE" claims sovereignty and Congress have not via legislation consented to claims against such a "federal SOE", the chances of any successful antitrust proceedings against such an enterprise are limited.[328] Therefore, according to the authors, there is limited antitrust jurisprudence in the United States on SOEs violating competition in comparison to other business practices that may violate antitrust laws.[329] It is also stated that the paucity of antitrust jurisprudence on SOEs, may be laid before the door of capitalism, as the United States never had a real appetite for nationalisation of industries even though there were some exceptions during times of war[330] and economic difficulties. It is also believed that the United States Constitution immunizes, to a great extent, anticompetitive behaviour by "government corporations".[331]

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[326] *See Lebron v National Rail Road Passenger Corp*oration 513 U.S. 374 (1995) 400.
[327] 499 U.S. 365 (1991) 388.
[328] DEM Sappington & JG Sidak "Competition Law for State-Owned Enterprises" (2003) 71 (2) *Antitrust Law Journal* 479 481.
[329] DEM Sappington & JG Sidak "Competition Law for State-Owned Enterprises" (2003) 71(2) *Antitrust Law Journal* 479 481.
[330] DEM Sappington & JG Sidak "Competition Law for State-Owned Enterprises" (2003) 71 (2) *Antitrust Law Journal* 479 481.
[331] DEM Sappington & JG Sidak "Anticompetitive Behaviour by State-Owned Enterprises: Incentives and Capabilities" in RR Geddes *Competing with the Government: Anticompetitive Behaviour and Public Enterprises* (2004) 1 1.

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The heyday of government controlled corporations in the United States was after the two world wars and during the Great Depression. The Supreme Court stated that the first "large-scale use" of SOEs happened during World War I.[332] However, all government-controlled corporations were dissolved after the end of the war.[333] The Great Depression was the next event in America's history which led to the establishment of SOEs. Corporations established during this time were meant to stabilise the American economy.[334] However due to the sheer number of SOEs that were created and "the lack of accountability", Congress at the time enacted the Government Corporation Control Act, which introduced certain strict measures in regard to government corporations.[335] These measures, inter alia, included the requirement to submit a "business-type budget" to the President, which the President then subsequently submitted to Congress,[336] the submission of an annual management report to the Congress not later than 180 days after the end of the corporation's fiscal year,[337] and the auditing of the corporation's financial statements.[338] Many of the government corporations were however dissolved after World War II but new ones were established in the 1960s, most of which were agencies situated within the federal government and thus exempted from the application of the antitrust laws.[339] In later years though, instead of establishing government corporations, the government started to sponsor corporations and these corporations were not "agencies or establishments" of the federal government and neither were they subjected to the provisions of the Government-Controlled

[332] Corporations such as the United States Grain Corporation, the United States Emergency Fleet Corporation, the United States Spruce Production Corporation, and the War Finance Corporation were created. See *Lebron v National R.R. Passenger Corp*. 513 U.S. 374 (1995) 388.
[333] *Lebron v National Rail Road Passenger Corporation* 513 U.S. 374 (1995) 388.
[334] *Lebron v National Rail Road Passenger Corp*oration 513 U.S. 374 (1995) 388. These corporations included the Reconstruction Finance Corporation, a corporation which was authorized by Congress to make loans to banks, insurance companies, railroads, land banks agricultural credit organizations. This corporation also got authorised by Congress to create SOEs without requiring congressional consent every time and it went on to create a number of other corporations during this time; the Federal Deposit Insurance Corporation, a corporation which was established to hold and liquidate the assets of failed banks and also to insure bank deposits; the Tennessee Valley Authority, a corporation established to help the Government to enter the commercial sale of goods and services.
[335] See *Lebron v National Rail Road Passenger Corporation* 513 U.S. 374 (1995) 388.
[336] See 31 U.S.C. § 9103.
[337] See 31 U.S.C. § 9106.
[338] See 31 U.S.C. § 9105.
[339] *See Lebron v National Rail Road Passenger Corporation* 513 U.S. 374 (1995) 390.

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Corporations Act.[340] Such "government-sponsored enterprises" could enter the market with "government –conferred advantages".[341]

At present the "appetite" to operate SOEs as part of the federal economy is still limited. However, a number of SOEs can be found operating as part of the economy though, within the individual states.

4 3 5 SOEs on state-level: Antitrust enforcement and the state-immunity principle

The Constitution of the United States of America states that:

> "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, anything in the Constitution or Laws of any State to the Contrary notwithstanding."[342]

The "Supremacy Clause" is clear that all state law is subjected to federal laws. Consequently any activities by the various states which may impact on free and fair competition when they act as market participants should thus be subject to the federal antitrust laws. However, various activities of the States which may impact on competition are exempted from the antitrust laws.[343] In the case of *North Carolina State Board of Dental Examiners v Federal Trade Commission*[344] the Supreme Court

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[340] *Lebron v National R.R. Passenger Corp.* 513 U.S. 374 (1995) 390.
[341] The Supreme Court used the Communications Satellite Corporation (Comsat) as an example in *Lebron v National Rail Road Passenger Corporation* 513 U.S. 374 (1995) 390.
[342] See the Supremacy Clause, U.S.C. Const. Art. VI cl. 2.
See also R Squire "Antitrust and the Supremacy Clause" (2006) 59 *Stanford Law Review* 77 77-130 for a detailed discussion on the Supremacy Clause and antitrust.
[343] See *Parker v Brown* 317 U.S. 341 (1943) which established the state-immunity principle.
See also JM Bona & LA Wake "The Market-Participant Exception to State-Action Immunity From Antitrust Liability" (2014) 23 (1) *Journal of the Antitrust and Unfair Competition Law Section of the State Bar of California* 156 156 where the authors states that: "a significant category of potentially-anticompetitive conduct often escapes antitrust scrutiny: state and local commercial activity. Governmental entities can, and do, enter the marketplace as competitors, and may have even stronger incentives than profit-maximizing firms to harm competition. Indeed, state and local entities have built-in advantages that may allow them to successfully monopolize, or otherwise injure competition."
[344] 135 S.Ct. 1101 U.S. (2015) 1104.

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stated that the federal antitrust laws are a "central safeguard" for free market structures within the United States but to require the various federal states to comply with the Sherman Act at the expense of other "values a State may deem fundamental" would place an "impermissible burden on the State's power to regulate. The first antitrust case in which antitrust immunity of the federal states was recognised was *Parker v Brown.*[345] In this case the United States Supreme Court stated that the Sherman Act does not mention a state as such and the statute further gives no indication that it was intended to restrain state action or any official action that was directed by a federal state. It was concluded that the Act is applicable to persons only, which includes companies.[346] The court further stated that the Sherman Act's legislative history provides no suggestion that a purpose of the Act was to restrain state action but that its founders only intended the Act to prevent 'business combinations' and that this purpose to prevent combinations that restrain competition and monopolies by individuals and corporations only, appears "abundantly" from the Act's legislative history.[347]

As a consequence the Parker principle or the state-action immunity principle[348] was established. In terms of this principle the various federal states of America are exempted from the application of the antitrust laws as long as they act in a sovereign capacity.[349] In *Federal Trade Commission v Phoebe Putney Health System Inc.*[350] the Supreme Court again emphasised the grounds on which any other body which is not a federal state may claim immunity from antitrust laws when a state has granted that body certain corporate powers to execute on its behalf. In this case the court had to decide whether a law of the State of Georgia that creates special-purpose public entities called hospital authorities and gives those entities general corporate

[345] 317 U.S. 341 (1943).
[346] *Parker v Brown* 317 U.S. 341 (1943) 350.
[347] See *Parker v Brown* 317 U.S. 341 (1943) 351.
[348] *Parker v Brown* 317 U.S. 341 (1943).
[349] *Parker v Brown* 317 U.S. 341 (1943) 313 where the Supreme Court stated that "The Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state." The principles of federalism were the basis for the court's decision. On page 350 the court stated that: "In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress."
For further mention on the importance of federalism as a reason for the introduction of the state-action immunity see *Federal Trade Commission v Ticor Title Ins. Co*. 504 U.S. 621 (1992).
[350] 133 S.Ct. 1003 U.S. (2013).

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powers, including the power to acquire hospitals, clearly articulates and affirmatively expresses a state policy to permit acquisitions that substantially lessen competition. The court had to clarify the position after such a hospital authority established in terms of the Georgia law wanted to acquire the only other hospital out of two which was not under its control within a county. The FTC complained that the acquisition would create a virtual monopoly and would substantially reduce competition in the market for acute-care hospital services in violation of section 5 of the Federal Trade Commission Act and section 7 of the Clayton Act. The court stated that in order to qualify for immunity from the antitrust laws the hospital authority had to show that the challenged restraint was one "clearly articulated and affirmatively expressed" as state policy.[351] It further stated that State-law authority to act on behalf of the federal state is insufficient to establish state-action immunity but the "substate governmental entity" has to show that it has been delegated authority by the federal state to "act or regulate anti-competitively."[352] The court concluded that there is no need for a state legislature to "expressly state" that the legislature intends for the delegated action to have anticompetitive effects but the anticompetitive effect must have been the "foreseeable result" of what the State authorized.[353] While the Georgia law in question does allow the hospital authority involved in the matter to acquire hospitals, it does not clearly articulate and affirmatively express a state policy empowering the hospital authority to make acquisitions of existing hospitals that will substantially lessen competition.[354] It also said that there was no evidence that the State of Georgia "affirmatively contemplated that hospital authorities would displace competition by consolidating hospital ownership".[355]

State-action immunity can thus only be invoked by governmental entities if the "challenged anticompetitive conduct" is undertaken in accordance with a regulatory scheme "that is the State's own" and when there is "clear articulation" of the State's

[351] *Federal Trade Commission v Phoebe Putney Health System, Inc.* 133 S.Ct. 1003 U.S. (2013) 1010. This requirement was first set by the Supreme Court in *City of Lafayette v Louisiana Power & Light Company,* 435 U.S. 389, 410, 98 S. Ct. 1123, 1135, 55 L. Ed. 2d 364 (1978) 1135.
[352] *Federal Trade Commission v Phoebe Putney Health System Inc.* 133 S.Ct. 1003 U.S. (2013) 1012.
[353] *Federal Trade Commission v Phoebe Putney Health System Inc.* 133 S.Ct. 1003 U.S. (2013) 1011.
[354] *Federal Trade Commission v Phoebe Putney Health System Inc.* 133 S.Ct. 1003 U.S. (2013) 1010.
[355] *Federal Trade Commission v Phoebe Putney Health System Inc.* 133 S.Ct. 1003 U.S. (2013) 1011.

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intent to displace competition.[356] If the State delegates its corporate powers to a private party to implement a state policy, an additional requirement applies in that the policy has to be actively supervised by the State.[357] Governmental entities to which States delegate their powers to execute policy are however not subject to the active state supervision requirement because "they have less of an incentive to pursue their own self-interest under the guise of implementing state policies."[358]

The state-action immunity principle was originally aimed at protecting state legislatures acting in their legislative capacities[359] as it ensured that any conflict between state sovereignty and America's commitment to a policy of robust competition would be avoided.[360] Now though, it may also be invoked by other governmental authorities, municipalities and private parties who are authorised by the federal states to implement policies on the states' behalf,[361] thus creating a "multi-tier immunity" from antitrust laws. This "multi-tier immunity" has been established by the three approaches which have been developed by the Supreme Court to analyse a state-action immunity defence.[362] These three approaches are (i) an "*ipso facto* immunity";[363] (ii) the "*Midcal* scrutiny";[364] and (iii) the "*Hallie*

[356] *Federal Trade Commission v Phoebe Putney Health System, Inc.* 133 S.Ct. 1003 U.S. (2013) 1010.
[357] *Federal Trade Commission v Phoebe Putney Health System, Inc.* 133 S.Ct. 1003 U.S. (2013) 1010. In *North Carolina State Board of Dental Examiners v Federal Trade Commission,* 135 S. Ct. 1101, 1117, U.S. (2015) 1117 the Supreme Court stated: "If a State wants to rely on active market participants as regulators, it must provide active supervision if state-action immunity under *Parker* is to be invoked."
[358] *Federal Trade Community v Phoebe Putney Health System, Inc.* 133 S.Ct. 1003 U.S. (2013) 1011.
[359] *Auraria Student House at the Regency LLC v Campus Village Apartments LLC* 843 F.3d 1225 10th Cir. (2016) 1249.
[360] *North Carolina State Board of Dental Examiners v. Federal Trade Commission* 135 S.Ct. 1101 U.S. (2015) 1110.
[361] *Auraria Student House at the Regency LLC v Campus Village Apartments LLC* 843 F.3d 1225 10th Cir. (2016) 1249.
[362] *Edinboro College Park Apartments v Edinboro University Foundation,* 850 F.3d 567, 572 3d Cir. (2017) 572.
[363] In regard to this approach, the court in *Edinboro College Park Apartments v Edinboro University Foundation,* 850 F.3d 567, 572 3d Cir. (2017) 572 said: "Once it is determined that the relevant action is "an undoubted exercise of state sovereign authority" undertaken by an actor "whose conduct ... automatically qualif[ies] as that of the sovereign state itself," that conduct is immune without the need for any further analysis." This approach only applies to acts of federal state legislatures and the decisions of a federal state's Supreme Court when it acts legislatively and not judicially.
[364] This approach is applied when a private party or state agencies "controlled by active market participants" seeks to invoke the state-action immunity principle. In this regard the private party has to comply with two requirements: firstly, it must have acted in accordance with a "clearly articulated and affirmatively expressed" state policy which permits anticompetitive conduct and secondly, the State must "actively supervise" the private party's conduct. *Edinboro College Park Apartments v Edinboro University Foundation,* 850 F.3d 567, 572 3d Cir. (2017) 572.

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scrutiny".[365] Which of the three approaches apply to a particular state-action immunity defence depends on whether the "relevant actor is comparable to a sovereign power, a private business, or something in between."[366]

But the scope of the state-action immunity principle has not gone unquestioned. Various agencies which include the Federal Trade Commission, the Antitrust Section of the American Bar Association and the Antitrust Modernization Commission[367] have commissioned reports on the anticompetitive effects of an "overly broad state action doctrine".[368] Various antitrust scholars have argued for a limited state action doctrine.[369] Economists view regulation of markets as justified only in situations where competition fails and state regulation and intervention have often gone beyond this.[370] With so many convincing arguments by antitrust scholars and economists, it could be realistic to expect that the Supreme Court would at one point review the scope of the state immunity doctrine as it has been applied since its inception in *Parker v Brown.* However, as recent as in February 2015 the Supreme Court said that federal states, when acting in their respective jurisdictions do not need to adhere "in all contexts to a model of unfettered competition."[371] The court further said that:

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[365] In terms of this approach municipalities are exempt from active supervision which is required by the "Midcal scrutiny" for private parties but it must still act in accordance with a "clearly articulated and affirmatively expressed" state policy which permits anticompetitive conduct. *Edinboro College Park Apartments v Edinboro University Found,* 850 F.3d 567, 572 3d Cir. (2017) 572.

[366] *Edinboro College Park Apartments v Edinboro University Foundation* 850 F.3d 567; 572 3d Cir. (2017) 572.

[367] This Commission was established to "examine whether the need exists to modernize the antitrust laws and to identify and study related issues." See Sec. 11053 on the Duties of the Commission published in PL 107–273, 2002 HR 2215. See also Antitrust Modernization Commission: Request for Public Comment (May 19, 2005) in 70 FR 28902-02, 2005 WL 1170267 (F.R.).

[368] See D Platt Majoras "State Intervention: A State of Displaced Competition" (2006) 13 *George Mason Law Review* 1175 1179. See also the Antitrust Modernization Commission's request for public comment on the exceptions and exemption to the antitrust laws.

[369] For various scholars' works which criticises the scope of the state immunity doctrine see AC Stine & ED Gorman "Putting The Lid On State-Sanctioned Cartels: Why The State Action Doctrine In Its Current Form Should Become a Remnant Of The Past " (2011) 66 *University of Miami Law Review* 123 123-139. S Weese "Eminent Need: Proposing A Market Participant Exception for Municipal Parker Immunity" (2011) 9 *Cardozo Public Law, Policy and Ethics Journal* 529 529-566. P Hettich "Mere Refinement of the State Action Doctrine Will Not Work" (2005) 5 *DePaul Business & Commercial Law Journal* 105 105-157. See also The State Action Exemption and Antitrust Enforcement under the Federal Trade Commission Act (1976) 89 *Harvard Law Review* 715 715-751.

[370] P Hettich "Mere Refinement Of The State Action Doctrine Will Not Work" (2005) 5 *DePaul Business & Commercial Law Journal* 105 106

[371] *North Carolina State Board of Dental Examiners v Federal Trade Commission* 135 S. Ct. 1101 U.S. (2015) 1109.

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> "If every duly enacted state law or policy were required to conform to the mandates of the Sherman Act, thus promoting competition at the expense of other values a State may deem fundamental, federal antitrust law would impose an impermissible burden on the States' power to regulate." [372]

Through this statement the court has undoubtedly indicated that there is nothing questionable about the scope of the state- action immunity principle since the application of the principle is "appropriately limited" by the three approaches above. Even if federal states use SOEs or other governmental bodies for implementing and executing state policies and the activities of such SOEs or other governmental bodies impact on competition, it will continue to be exempted from the application of the antitrust laws as long as such bodies are executing a "clearly articulated and affirmatively expressed" state policy and has the delegated authority by the federal state to "act or regulate anti-competitively." Out of respect for the federalism principle, Congress will also not through the enactment of legislation interfere with the state-action immunity doctrine as it is currently applied.

4 3 6 Concluding remarks on US antitrust law

In conclusion it can be observed that the Sherman Act was the first statute to regulate restrictions on competition. Its significance is immense as it not only established antitrust law within the US but it also paved the way for competition law in many other countries. However, the US does not have a state aid control regime. The position on SOEs and state aid in the US is very well summarised by Collins[373] when he states that:

> "The United States was the first nation to develop a comprehensive body of antitrust law, yet unlike the European Union, it has failed to enact legislation designed to combat the anticompetitive effects that subsidies and other state-aid initiatives may

[372] *North Carolina State Board of Dental Examiners v Federal Trade Commission* 135 S. Ct. 1101 U. S. (2015) 1109.
[373] AR Collins "Is the regulation of state-aid a necessary component of an effective competition law framework" (2005) 16(2) *European Business Law Review* 379 379.

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> have upon unfettered business competition in national and multinational markets."[374]

SOEs are a "little-know business organization in the United States"[375] and was never really popular. For this reason there was thus no need for an EU-style state aid control regime. The market integration in Europe also distinguishes it from the US. The control of state aid in the EU formed an integral part of the drive to achieve a single-market.[376] If member States were allowed to provide unregulated state aid to any of its own undertakings, the idea of a single integrated European market would be undermined.[377] This concern again does not exist in the US.

It is claimed that antitrust enforcement in the US became reinvigorated under the Obama administration and after years in the "wilderness" antitrust enforcement became a hot topic again.[378] During the Reagan and Bush (G.W.) administrations antitrust enforcement by the Justice Department and the Federal Trade Commission slumped while a slight uplift occurred during the Clinton administration.[379] However, Obama made vigorous antitrust enforcement part of his election campaign.[380] Crane sets out five reasons for the revival of antitrust laws. Firstly, the laissez faire Chicago school perspective which dominated antitrust from the late 1980s ran its course and the time had arrived for a more "interventionist regime", secondly, antitrust scholars had to a large extent started to call into question the Chicago school's anti-interventionist approach to antitrust enforcement, thirdly, President Obama had a sincere interest in the enforcement of antitrust laws and this interest was displayed with the calibre of people he appointed to head the Antitrust Division to make good on the promise he made during his presidential campaign that he would appoint "an antitrust division in the Justice Department that actually believes in antitrust law", fourthly, the laissez faire ideology had been undermined by the 2008 financial crisis

[374] This view is shared by other scholars. Graham states that "US law assumes that certain activities can be removed from the scope of the anti-trust law if the federal state and state authorities think this is appropriate" See C Graham *EU and UK Competition Law* (2010) 301.
[375] M Judd "Sources on State-owned enterprises" (1981) 59(3) *Harvard Business Review* 158 158.
[376] See the discussion on this aspect in par 2 of chapter 4. See also P Craig & G De Burca, *EU Law Text, Cases and Materials* 3rd ed (2003) 1122.
[377] P Craig & G De Burca *EU Law Text, Cases and Materials* 3rd ed (2003) 1122.
[378] DA Crane "Obama's Antitrust Agenda" (2009) 32 *Regulation* 16 16.
[379] DA Crane "Obama's Antitrust Agenda" (2009) 32 *Regulation* 16 17.
[380] JD Harkrider "Obama: The First Year" (2010) 24 (3) *Antitrust Magazine* 8 8.

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and the need for large scale government intervention precipitated by it and lastly, the growing rate with which other countries started to implement and enforce antitrust laws also played a role in its renaissance.[381]

With more and more countries now adopting competition policies and laws that are mostly based on the United States' antitrust laws and EU competition laws and with the many US multi-national firms operating business across the globe, it is reasonable to believe that the United States antitrust law will continue to serve as an influence.[382] However when it comes to the position of SOEs, United States antitrust law is somewhat underdeveloped and hence it cannot serve as clear guidance. Even so, the wider United States learning on antitrust will remain important, also to the development of laws to address anti-competitive acts of SOEs.

4 3 7 Statutory Competition law in the EU[383]

4 3 7 1 Introduction

> "From a legal perspective, competition law has been at the centre of the EU law and European integration for the past fifty years."[384]

[381] DA Crane "Obama's Antitrust Agenda" (2009) 32 *Regulation* 16 16-17.

[382] New developments in US antitrust law might also create interest amongst antitrust/ competition law policy makers and scholars around the world. A new movement known as the "Hipster Antitrust Movement/ New Brandeis School or New Progressive Antitrust Movement might again change the face of antitrust in the US as it is known at present. For a comprehensive read on this movement see JD Wright, E Dorsey, J Klick & JM Rybnicek "Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust" (2019) 51(1) *Arizona State Law Journal* 293 294-295. The authors state: "At its core, the Hipster Antitrust movement calls for a total rejection of the commitment to economic methodology and evidence-based policy that lies at the heart of modern antitrust enforcement. The Hipster Antitrust movement would reject Chicago School free marketers' approach to antitrust just as readily as it would Post-Chicago interventions." They continue by saying that the "new revolution lays at antitrust law's feet a myriad of perceived socio-political problems, including, but not limited to, rising inequality, employee wage concerns, and the concentration of political power." Its policies include specifically "a return to "big-is-bad" antitrust enforcement based upon firm size without regard for effect on consumers, making presumptively unlawful broad categories of mergers and acquisitions outright (e.g., all mergers beyond a certain size threshold even in the absence of potential horizontal or vertical issues), and abandoning the consumer welfare standard to take into account effects on income inequality and wages." It remains to be seen to what extent this movement will bring significant changes to US antitrust law, considering its rising influence amongst scholars, think tanks and "prominent members of Congress.

[383] EU competition policies in regard to SOEs will be discussed and examined in greater detail in chapter four of this study. In this chapter though, the origin, development and application in member states of EU competition policies and law will be discussed.

[384] KK Patel & H Schweitzer *The Historical Foundations of EU Competition Law* (2013) 1.

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This was achieved through the various founding treaties of the EU, the implementation of more rules and policies regulating competition to strengthen the competition regime and of course greater European integration,[385] during which the economic conditions in newly admitted member states were closely scrutinized to ensure that a coherent EU competition law regime would be maintained. Like the United States' antitrust law, EU competition law also serves as a benchmark for many countries when implementing competition policy and law.

The EU position on SOEs and competition is however substantially different from the American approach. This part on EU competition law will focus mainly on the origin and development of the EU competition law, its application within selected member states, namely Britain, Germany and France, and its relevance for the operations of SOEs. A more detailed discussion on the EU's state aid policy relating to undertakings and in particular public undertakings (SOEs in South Africa), which are the focus of this study, will follow in chapter four.

4 3 7 2 EU treaties, Competition law and their relevance for public undertakings

After World War II, which ravaged nearly every state in Europe, it must have been difficult to foresee that, in the future there would be peace through supranational cooperation. The initial supranational cooperation was made possible by the sheer will and determination of six European countries which are Belgium, France, Italy, Luxembourg, the Netherlands and West Germany. The devastation in these countries brought about by the war served as an incentive for these European leaders to unite Europe.[386] The "founding fathers" of European integration, Germany's Konrad Adenauer, France's Robert Schuman, Italy's Alcide de Casperi, Luxembourg's Joseph Bech, the Netherlands' Johan Willem Beyen, Belguim's Paul

[385] European integration has been described as "the historical process whereby European nation-states have been willing to transfer, or more usually pool, their sovereign powers in a collective enterprise" and the European Union and its institutional structures is the outcome of the process. See M Gilbert *European Integration: A Concise History* (2012) 1-5.
[386] M Gilbert *European Integration: A Concise History* (2012) 9.

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Henri Spaak and Britain's Winston Churchill knew that "civilized life" in Europe could only be achieve again through greater unity.[387]

A "United States of Europe"[388] was desired. And so the first integration efforts started with the establishment of the Coal and Steel Community (ECSC) in 1951 by Belgium, France, Italy, Luxembourg, the Netherlands and West Germany.[389] This Community was established after Robert Schuman, the then French Foreign Minister, suggested that the coal and steel industries of Germany and France should be placed under one authority.[390] The purpose was to create a single market in coal and steel,[391] to prevent any "protectionist cartels" in the coal and steel industry and to spread the "social costs" of modernising these industries.[392] The treaty establishing the ECSC was only meant to be in force for fifty years and thus expired in July 2002 and the ECSC ceased to exist.[393] Nevertheless, this Community laid the foundation for more European integration and its institutional framework also set the example for the institutional framework of those European Communities that followed.

In January 1958 the European Economic Community (EEC), followed when the Treaty of Rome (the Treaty establishing the European Economic Community or EEC Treaty) entered into force.[394] Unlike the ECSC Treaty which focused mainly on one aspect of cooperation, namely on the coal and steel industry, this treaty concerned

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[387] M Gilbert *European Integration: A Concise History* (2012) 10.

[388] A term coined already in the mid-nineteen century but made popular again by Britain's Winston Churchill when he called for a "United States of Europe" after the end of World War II.
See H Porsdam *From Civil to Human Rights: Dialogues on Law and Humanities in the United States and Europe* (2009) 114.

[389] The treaty establishing the ECSC, however, only entered into force in 1953.

[390] J Fairhurst *Law of the European Union* 8th ed (2010) 5.

[391] See J Steiner & L Woods *EU Law* 10th ed (2009) 4.

[392] M Gilbert *European Integration: A Concise History* (2012) 35.

[393] A Kaczorowska *European Union Law* 2nd ed (2011) 8.

[394] M Gilbert *European Integration: A Concise History* (2012) 5.
The European Atomic Energy Community (EURATOM) was established at the same time than the EEC.
Article 2 of the EEC Treaty determines that: "It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States."
At the same time the treaty which established the European Atomic Energy Community (EURATOM) was signed. This Community was meant to provide greater cooperation amongst the six signing nations in matters regarding the use of atomic energy.
See J Fairhurst *Law of the European Union* 8th ed (2010) 6.

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broader economic cooperation between member states. The implementation of competition policy within the EEC formed part of this treaty.[395] The EEC Commission established the following objectives as the three fundamental principles of EEC competition policy (i) to create and maintain a single market for the benefit of consumers and business, (ii) to prevent large businesses from engaging in anticompetitive behaviour, and (iii) the support by the EEC of production, distribution and technological development.[396]

Thus, besides establishing a "common market" between the founding member states, which covered all "economic fields" except the areas covered by the ECSC and the EURATOM,[397] the EEC Treaty also became the first "supranational antitrust agreement" with the European Commission (the EU Commission) as its enforcer.[398] The important provisions of the EEC Treaty which dealt with competition are found in sections 85 to 94 of the treaty.[399] Article 85 of the EEC Treaty dealt with agreements between enterprises, decisions by associations of enterprises and concerted practices which may affect trade between the member states and which have as their object or result the prevention, restriction or distortion of competition within the common market. Article 86 of the EEC Treaty dealt with the abuse by a dominant enterprise of its position, while articles 92 to 94 dealt with aid granted by member states to favour certain enterprises or the production of certain goods. The founding treaty had no provisions on merger regulation. Article 3 of the treaty, however, gave the Commission the authority to establish a system which would ensure that competition within the EEC is not distorted.[400] Even though it was found that articles 85 and 86 were also applicable to concentrations within the EEC, it was considered not sufficient to ensure that competition is not distorted through concentration.[401] Consequently the EEC enacted its first "legal instrument" to control mergers in

[395] J Fairhurst *Law of the European Union* 8th ed (2010) 7.
[396] See RJA de Seife "French and EEC Competition Law: GATT and U.S. Foreign Trade Policy Post-1992" (1992) 71 *Nebraska Law Review* 488 525.
[397] J Fairhurst *Law of the European Union* 8th ed (2010) 7.
[398] M Gilbert *European Integration: A Concise History* (2012) 55.
[399] Of particular importance for this study are sections which deals with State aid granted to undertakings and which will be discussed in greater detail in chapter four of this study.
[400] Article 3(f) provides for the "the establishment of a system ensuring that competition shall not be distorted in the Common Market."
[401] See the Preamble of the Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings published in the *Official Journal of the European Community* L 395 30/12/1989 1.

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December 1989 through the Council Regulation[402] on the control of concentrations between undertakings. This was the EEC's first "community policy" on concentrations between undertakings

After many amendments to the EEC Treaty by various other treaties since its inception in 1958,[403] the numbering[404] of the founding articles has been changed, the name of the EEC has been changed and also the name of the ruling treaty is different but the foundational principles have basically remained the same. These aspects are detailed in chapter four.[405] Today provisions dealing with competition within the EU, as the EEC is known since the Maastricht Treaty entered into force in 1993, are found in sections 101 to 109 of the TFEU.[406] Council Regulation (EC) 139/2004 (the "EC Merger Regulation") is the existing legal instrument which governs mergers and has been described as "the most far-reaching reform of European merger control"[407] since the first merger control system became effective on 21 September 1990. The EC Merger Regulation brought merger control in the EU in line with a more integrated market and possible further enlargement of the EU.[408]

a) Applicability of EU competition law to undertakings including public undertakings

[402] See Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings.
[403] Treaties which amended the founding treaty of the European Union as the EEC is known today include the Brussels Treaty of 1965, the Single European Act of 1986, the Maastricht Treaty of 1994, the Treaty of Amsterdam of 1997, the Treaty of Nice of 2001 and the Treaty of Lisbon of 2007.
[404] When reference is made in this chapter to the old numbering of the EEC Treaty, the new corresponding numbering in the Treaty on the Functioning of the European Union will be indicated.
[405] See para 3.1 of chapter four.
[406] Of importance to this study are those provisions found in sections 107 to 109 which deal with aids granted to undertakings by EU member states. The EU State Aid Model will thus be the exclusive focus in chapter four of this study. A comprehensive discussion of all the other provisions on competition matters namely those dealing with anti-competitive agreements, abuse of dominance and mergers, is beyond the scope of this study.
[407] P Verloop & V Landes *Merger Control in Europe: EU, Member States and Accession States* (2003) xxiii
[408] See the Preamble of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) in the *Official Journal of the European Communities* L 24/1 (29.1.2004).

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The above EU competition rules apply to all undertakings equally, regardless of their ownership. In *Hofner and Elser v Macrotron*[409] it was stated that:

> "…in the context of competition law the concept of an undertaking encompasses every entity engaged in economic activity, regardless of the legal status of the entity and the way in which it is financed."

Hence there is no special treatment for public undertakings.[410] Within the EU SOEs are known as "public undertakings". For as long as the public undertaking is a market participant that performs economic activity, the competition rules will apply to it. If a member state grants special or exclusive rights to public undertakings, the member state's conduct will have to comply with special competition rules in the TFEU.[411] The level of state involvement within the national economies in each EU member state differs considerably[412] and the European Commission acknowledges that public undertakings play substantial roles in the national economies of member states.[413] Nonetheless, there should be no "unjustified discrimination between public and private undertakings in the application on the rules on competition".[414]

European integration[415] especially the creation of the internal market had a strong impact on the role of SOEs within economies of member states of the EU. The internal market was established by the Single European Act of 1986 (Single European Act). Gilbert states that the Single European Act was the most important

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[409] C-41/90 [1991] ECR 1-1979 para 2. This description can also be found C Graham *EU and UK Competition Law* (2010) 67. See para 2 of chapter 1 for a discussion of the concept of undertaking within the EU.
[410] See para 2.1.1 of chapter 1 for a definition of a public undertaking within the EU.
[411] Article 106 of the TFEU.
[412] W Sauter & H Schepel *State and Market in European Union Law: The Public and Private Spheres of the Internal Market before the EU Courts* (2009) 19.
[413] See paras 2-4 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings.
[414] See paras 2-4 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings. The internal market gets described as "The internal market is one of the pillars of the European Union. Completed in 1992, the single market is an area without internal frontiers in which persons, goods, services and capital can move freely, in accordance with the Treaty establishing the European Community", http://europa.eu/legislation_summaries/internal_market/internal_market_general_framework/index_en.htm (accessed on 1 March 2015).
[415] European integration has been described as the "historical process whereby European nation-states have been willing to transfer, or more usually pool, their sovereign powers in a collective enterprise. The European Union (EU) is the outcome of this process." See M Gilbert *European Integration: A Concise History* (2012) 1.

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development for economic and political integration since the signature of the treaty which established the EEC.[416] Article 13 of the Single European Act provides that:

> "The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992…
> The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

The four key pillars of the internal market is the free movement of goods, persons, services and capital.[417] Public undertakings, like their private counterparts, are providers of services and goods. Since competition rules are to be applied equally to public undertakings and private undertakings, public undertakings need to comply with treaty rules regarding competition. Consequently the Commission requires a transparent financial relationship between public undertakings and member states.[418] In order to ensure proper application of the rules of competition to public undertakings, the Commission requires that detailed accounts are kept and made available on request to the Commission. Such accounts should indicate "the distinction between different activities, the costs and revenues associated with each activity and the methods of cost and revenue assignment and allocation.[419] This ensures that the relation between the State and SOEs does not at any point distort competition.

b) Enforcement of the EU Competition rules

All the above rules including the state aid rules[420] are enforced by the Directorate General for Competition at the EU Commission.[421] The EU Commission has been

[416] M Gilbert *European Integration: A Concise History* (2012) 117.
[417] J Steiner & L Woods *EU Law* 10th ed (2009) 345.
[418] See para 7 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings.
[419] See para 15 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings.
[420] See the discussion on state aid within the EU in chapter four.

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described as a "market invigilator" and "a watchdog that barked whenever mercantilist tendencies tried to sneak into the market by the back door and a bloodhound employed to sniff them out".[422]

The centralised system of enforcing EU competition law which was established by Council Regulation No 17 of 6 February 1962[423] has now been replaced by a decentralised enforcement system.[424] Lawmakers of the EU were mindful of the need to balance effective supervision of the enforcement of EU competition law and the need to simplify the administration burden of the Commission, when the decentralised system was considered.[425] In terms of the current enforcement regime member states thus have the competence to designate those competition authorities which are responsible for the application of Articles 81 and 82 of the EC Treaty (today Articles 101 and 102 of the TFEU) in compliance with Council Regulation (EC) No 1/2003 and these authorities include courts.[426] In terms of the current legislation the competition authorities and courts of all member states have thus now concurrent power with the Commission to apply Article 101(1) of the TFEU (formerly Article 81 (1) of the EC Treaty) and Article 101(3) of the TFEU (formerly Article 81 (3) of the EC Treaty) as well as Article 102 of the TFEU (formerly Article 82 of the EC Treaty).[427] There is however a limitation on the concurrent jurisdiction of the national competition authorities. Any ruling by the competition authorities of the member state on agreements, decisions or practices under Article 101 and Article 102 of the TFEU which is also the subject of an EU Commission decision, cannot run counter to a

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[421] See B Buehler, G Koltay, X Boutin & M Motta "Recent Developments at DG Competition: 2013–2014" (2014) 45 (4) *Review of Industrial Organization* 399 399-415 for the enforcements actions taken by the EU Commission in regard to the various aspects of competition.

[422] M Gilbert *European Integration: A Concise History* (2012) 55.

[423] This was the first Regulation which implemented Articles 85 and 86 of the Treaty.

[424] See para 3 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty in the *Official Journal of the European Communities* L 1/1 (4.1.2003). See also WPJ Wils *Principles of European Antitrust Enforcement* (2005) 3

[425] See para 2 of the Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty in the *Official Journal of the European Communities* L 1/1 (4.1.2003).

[426] See Article 35 (1) of the of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty in the *Official Journal of the European Communities* L 1/1 (4.1.2003).

[427] See Articles 5 and 6 of the of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty in the *Official Journal of the European Communities* L 1/1 (4.1.2003).

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decision which the Commission adopted.[428] The decentralised system not only lightens the Commission's administrative burden, but another benefit might also be speedier decisions on possible anticompetitive practices. National competition authorities focus on anticompetitive behaviour within their respective jurisdictions, and may ensure speedy decisions.

Nonetheless, those articles of the TFEU which deal with state aid to undertakings by member states and which form part of the EU competition rules, namely Articles 107 to 109 are only enforceable by the Commission.[429] It is the only institution which can decide on the legality or not of state aid to undertakings by member states. Member states may however, have institutions which advise undertakings affected by possible state aid on EU state aid regulations. Article 13 of the TEU states that:

> "The Union shall have an institutional framework which shall aim to promote its values, advance its objectives, serve its interests, those of its citizens and those of the Member States, and ensure the consistency, effectiveness and continuity of its policies and actions."

The treaty further states that:

> "In carrying out its responsibilities, the Commission shall be completely independent…the members of the Commission shall neither seek nor take instructions from any Government or other institution, body, office or entity. They shall refrain from any action incompatible with their duties or the performance of their tasks.[430]

It is submitted that in regard to the application of the EU state aid rules, consistency and independence of the Commission is of utmost importance. Firstly, the requirement in regard to consistency ensures that the state aid rules are applied to all member states in the exact same way without any deviation from the regulatory position. If this was not the case a situation may arise in which a member state

[428] See Article 16 (2) of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty in the *Official Journal of the European Communities* L 1/1 (4.1.2003).
[429] See para 8 of chapter 4 for more on the enforcement of the EU state aid rules.
[430] Article 17 (3) of the TEU.

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wants to grant aid to an undertaking operating within its border and its competition authorities might judge the aid not to contravene competition while if the EU Commission had to decide, the outcome could be otherwise. This might thus affect the uniform application of the state aid rules. Secondly, since the Commission is expected to be completely independent without taking instructions from any government, office or entity, any possibility of national authorities perhaps not standing up to their government if they were to apply state aid rules is excluded. The EU Commission is thus better placed to assess whether state aid by a member state to any undertaking might distort competition.

4 3 7 3 Implementation of EU Competition law in selected member states: Britain, Germany and France

a) Statutory Competition law in Britain

> "All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties, and all such remedies and procedures from time to time provided for by or under the Treaties, as in accordance with the Treaties are without further enactment to be given legal effect or used in the United Kingdom shall be recognised and available in law, and be enforced, allowed and followed accordingly."[431]

The above provision in Britain's European Communities Act recognises the supremacy of EU law, including competition law. Britain has quite a story to tell about its initial ambitions to become a member of the EEC. At first Britain made two attempts to join the EEC but both failed.[432] The first objection against British membership of the EEC was in 1963 by President De Gaulle backed by Germany's Konrad Adenauer and the second refusal for membership was in 1967, again by President De Gaulle. De Gaulle used France's veto right[433] to block British membership since he felt that British membership to the EEC would weaken the

[431] See Section 2 of Britain's European Communities Act 1972.
[432] See M Gilbert *European Integration: A Concise History* (2012) 76-83.
[433] A Williams *UK Government and Politics* 2nd ed 1998) 214.

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community. As a result of the two failed membership attempts the administration of Prime Minister Harold McMillan refrained from another admission application while De Gaulle was still in office.[434] At the time Britain was still a colonial empire with close ties to the Commonwealth and a "special relationship" with the United States, which the six founding member states of the EEC especially France, felt could "disrupt the economic arrangements agreed by "The Six".[435] Britain only restarted its process to join the EEC after De Gaulle resigned from the French presidency in April 1969.[436] It became a member state of the EEC[437] after the enactment of the European Communities Act 1972, in January 1973 under the leadership of Prime Minister Edward Heath and at a time when "a crisis-hit Britain was desperate to join on almost any terms".[438]

Gilbert states that there were three determining factors in regard to Britain's desire to become a member state of the EEC: the first was driven by its poor economic performance in comparison with those countries which were member states of the EEC, the second was the realisation that greater European unity was essential in a world where "political and economic power [was] becoming more [concentrated] to such a great extent" and thirdly, the success of the EEC in its initial stages had convinced Britain that it wanted to be part of such a success story.[439] With Britain's admission the "Six" became the "Nine"[440] and Britain became subject to all EEC rules covered in the EEC Treaty including those that deal with competition matters. Since its admission to the EEC in 1972, Britain enacted a variety of laws to govern competition. These include the Competition Act 1980,[441] the Fair Trading Act of

[434] A Williams *UK Government and Politics* 2nd ed (1998) 214.
[435] M Gilbert *European Integration: A Concise History* (2012) 69-76.
[436] M Gilbert *European Integration: A Concise History* (2012) 86 and A Williams *UK Government and Politics* 2nd ed (1998) 214.
[437] The EEC is today known as the EU after the enactment of the Maastricht Treaty.
[438] M Gilbert *European Integration: A Concise History* (2012) 93.
[439] M Gilbert *European Integration: A Concise History* (2012) 69.
[440] Ireland and Denmark was admitted to the EEC at the same time as the United Kingdom.
[441] "an Act to make provision for the control of anti-competitive practices in the supply and acquisition of goods and the supply and securing of services; to provide for the making of grants to certain bodies;" See the Preamble of this Act.

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1973,[442] the Resale Prices Act of 1976[443] and the Restrictive Trade Practices Act of 1976.[444]

However, in the nineties Britain's competition law underwent a substantial overhaul in order to align it further with EU Competition law.[445] Today the two important statutes, namely the Competition Act 1998 (the Competition Act) and the Enterprise Act 2002 (the Enterprise Act), govern competition within Britain. Britain's competition legislation represents now a "United Kingdom version of European Union competition policy".[446] Provisions of the TFEU on prohibited agreements, decisions by associations of undertakings or any practices which may prevent, restrict or distort competition are reflected in section 2 of the Competition Act, while the TFEU provisions on the abuse of dominance are reflected in section 18 of the Competition Act. The Enterprise Act provides, inter alia, for merger regulation, market investigations and the introduction of a cartel offence. The Competition and Market Authority[447] is the principal body responsible for administering and enforcing the Competition Act.

As stated above,[448] sections 107 to 109 of the TFEU are directly enforce by the EU Commission. Hence, all state aid considered by a government organ in Britain has to be reported to the EU Commission in order for the Commission to determine whether such aid will have a harmful effect on competition. Any complaints of "unlawful" state aid provided by any branch of the British government to an undertaking which has the potential to distort competition, is lodged directly with the EU Commission. The

[442] This Act makes provision for the appointment of certain institutional bodies such as the Director General of Fair Trading and a Consumer Protection Advisory Committee and confers on these bodies the functions for the protection of consumers. See the Preamble of this Act.
[443] This Act prohibited certain anti-competitive behaviour such as "collective resale price maintenance" and "individual resale price maintenance". This Act has been repealed by the Competition Act 1998.
[444] An Act which dealt with prohibited restrictive agreements for goods and services. This Act has been repealed by the Competition Act 1998.
[445] C Graham *EU and UK Competition Law* (2010) 45.
[446] C Graham *EU and UK Competition Law* (2010) 18.
[447] The CMA succeeded the Office for Fair Trading after it ceased to exist on 1 April 2014. See *Skyscanner Ltd v Competition and Markets Authority* [2015] 3 All ER 67 69. See also the Sections 25-26 of the Enterprise and Regulatory Reform Act 2013 which established the CMA and abolished the Competition Commission and the Office for Fair Trading.
[448] See para 4.3.7.2 of this chapter.

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Commission will then investigate such complaints and if necessary will request information from the Member state concerned, in this case Britain.[449]

A seismic change, however, came on 23 June 2016 when the British people voted to leave the EU during a referendum. Britain's planned exist from the EU will have an impact on how EU rules and laws are applied and this includes the competition and state aid rules. The European Union (Withdrawal) Act of 2018, which received Royal Assent on 9 September 2019, provides some guidance in regard to this. The EU Withdrawal Act provides for the retention of existing EU laws.[450] In terms of the Act, direct EU legislation, which refers to any EU regulation, EU decision or EU tertiary legislation which is in effect immediately before the day Britain will exit the EU, will form part of British law after it leaves the EU.[451] Vickers states that although Britain's current primary legislation on competition will continue to apply as they currently do because these are independent UK statutes and "will not fall over when Brexit happens", there will be consequences and strains of various kinds.[452] Some of these consequences and constrains have been touched upon by Michael Grenfell, Executive Director of the Competition and Markets Authority, during a speech at the Advanced EU Competition Law Conference.[453] Those concerns listed include:

"(i) the duplication involved in parallel investigations of mergers and anti-competitive practices;

(ii) the risk of an 'enforcement gap' for UK consumers if there are no parallel investigations;

(iii) the risks to business certainty if there is divergence from EU norms in competition enforcement;

(iv) the loss of effectiveness from being outside the cooperation mechanisms of the European Competition Network (especially as regards authorities sharing confidential information on suspected anti-competitive practices);

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[449] See Article 10 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty in the *Official Journal of the European Communities* 27/3/1999.
[450] EU Withdrawal Bill, https://publications.parliament.uk/pa/bills/lbill/2017-2019/0102/18102.pdf.
[451] Section 3 of the EU Withdrawal Bill.
[452] J Vickers "Consequences of Brexit for competition law and policy" (2017) 33 (S1) *Oxford Review of Economic Policy* S70 S73. The author note different factors that will have an impact on merger regulation and also on antitrust.
[453] https://www.gov.uk/government/speeches/a-view-from-the-cma-brexit-and-beyond (last visited on 10 June 2018).

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(v) the loss of UK voices in the EU institutions to influence the development of EU competition law and policy; and
(vi) at the CMA, a lack of adequate funding which might, for example, reduce the CMA's ability to conduct the full range of their activities such as market investigations when staff have to be diverted to handle mergers that would previously have been examined exclusively by the EU Commission."

It is the above concerns and many others that prompted the House of Lords to publish a report on competition and state aid rules post-Brexit, after it received submissions from various experts and institutions.[454] It has done the same in regard to other policy areas and Brexit. Some of the questions on competition rules which the experts wanted the UK government to address either in the EU Withdrawal Bill or during exit negotiations with the EU include:
(i) The position in regard to block exemptions since businesses appreciate that the current EU block exemptions "ensure that certain types of agreements do not fall foul of either EU or UK antitrust prohibitions." The experts feel that similar arrangements should continue to apply under UK law after Brexit "to provide certainty and minimise disruption for businesses". They suggest that the government also need to clarify the extent to which the UK will continue to "take account of future EU block exemptions."[455]
(ii) The jurisdiction over competition cases during any transition period since the initial position papers regarding ongoing judicial and administrative proceedings at the point of Brexit shows two different approaches by the EU and the UK government. The EU's suggestion is that withdrawal should not deprive the Court of Justice of its competence to adjudicate in proceedings which are pending on the withdrawal date, while the UK's position is that Court of Justice should not remain competent to rule on cases which it has not decided on before withdrawal even if the facts arose before withdrawal. [456]
(iii) The type of cooperation that will exist between the UK and the EU as it will be in the mutual interest of both the EU and the UK to continue to cooperate on

[454] See House of Lords European Union Committee 12th report of Session 2017- 19- Brexit: Competition and State Aid (available at https://publications.parliament.uk/pa/ld201719/ldselect/ldeucom/67/67.pdf).
[455] Para 83 of the House of Lords Report on Brexit and Competition.
[456] Para 110 of the House of Lords Report on Brexit and Competition.

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competition matters post-Brexit. The view is that any such agreement should enable "reciprocal evidence-sharing", including confidential information.[457]

(iii) The position in regard to State Aid control after Brexit. Most of the expert submissions were favourable towards the EU state aid regime. They noted that despite frustrations with the application of the state aid rules, there was no clear evidence that the rules have curtailed successive UK governments' ability to grant state aid. It was also admitted that although there are delays when the state aid rules are applied, the checks and balances entrenched in these rules are not necessarily a bad thing.[458]

It is clear from the Lords' Report that the UK government will have to address an extensive number of issues in regard to competition policy after Brexit. It is submitted that the position in regard to antitrust rules that were applied before exit, might not change significantly. This is also because antitrust rules all over the world focus on mostly the same aspects of competition. Where significant policy changes could be expected is in regard to the state aid rules. If the UK however envisages a close trade relationship with the EU, any departure from the EU position on state aid control, might become a sticky point during the exit negotiations with the EU and in establishment of trade relations. It was therefore encouraging when Andrew Griffiths, a former Minister for Small Business, Consumers and Corporate Responsibility, confirmed that the UK government is looking to establish its own state aid regulatory framework enforced by the Competition and Markets Authority. The Minister stated:

> "the Government has concluded that at the point an independent UK State aid authority is required, the Competition and Markets Authority (CMA) would be best placed to take on the role of State aid regulator. This reflects its experience and understanding of markets as the UK's competition regulator and the independence of its decision-making from Government. By establishing a clear regulatory function, the Government believes we can provide assurance that the rules will be operated fairly throughout the UK internal market. We are continuing to engage with the

[457] Para 168 of the House of Lords Report on Brexit and Competition.
[458] Paras 170-202 of the House of Lords Report on Brexit and Competition.

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> Devolved Administrations about the regulation of State aid, so that the new framework works for the whole of the UK."[459]

This vision by the government has now been formulated in the "State Aid (EU Exit) Regulations 2019". As expected, it aligns closely with EU state rules and will come into force on the day Britain will exit the EU.

b) Statutory Competition law in Germany

Germany's first post-World War II Minister for Economic Affairs, Ludwig Erhard, believed in "prosperity through competition". He believed that "Competition is the most promising means to achieve and to secure prosperity".[460] Erhard was thus the founding father of the "social market economy" ("die soziale Marktwirtschaft") in Germany.[461] Since Germany was one of the founding members of the EEC, it was one of the first countries to adhere to the supranational competition policy which includes the state aid rules of the EU. Germany's first legislation on competition was enacted in 1958. The Act against Restraint of Competition (Gesetz gegen Wettbewerbsbeschränkungen-GWB), however, had some predecessors in the form of "decartelization and deconcentration laws" which were enacted by the Allied nations[462] after the end of World War II.[463]

After the Bonn Conventions of 1955[464] transferred authority from the occupied powers back to the German government, the Adenauer administration enacted the GWB.[465] The GWB was crucial to the establishment of a free market economy in Germany, especially since the Nazi era saw an economy that was "fully planned,

[459] http://data.parliament.uk/DepositedPapers/Files/DEP2018-0337/280318_-_Letter_Andrew_Griffiths_to_Rt_Hon_Lord_Whitty.pdf (visited on 10 June 2018).
[460] See L Erhard *Prosperity through Competition* (1958) 1.
[461] See the discussion in para 2 2 chapter 2 on "SOEs in the Federal Republic of Germany post-World War II" where Erhard's position in regard to competition is mentioned. For a general overview on Ludwig Erhard's economic policies see L Erhard *Prosperity through Competition* (1958).
[462] Allied nations refer to Britain, France and the United States, which occupied Germany after the war.
[463] HS Harris *Competition Law Outside the United States* 2nd ed. (2001) 6.
[464] These conventions encapsulate the Protocol on the Termination of the Occupation Regime in the Federal Republic of Germany. See "United States Treaties and other International Agreements" (1955) 6(4) United States Government Printing Office 4117 4117.
[465] I E Schwartz "Antitrust Legislation and Policy in Germany: A Comparative Study" (1957) 105(5) *University of Pennsylvania Law Review* 617 617-818.

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controlled, and monopolized".[466] Section 1 of the GWB prohibits agreements that restrict competition, section 19 prohibits the abuse of a dominant position by an undertaking, chapter 5 of the Act contains special provisions for certain sectors of the economy such as agriculture and the energy sector and chapter seven of the Act regulates concentrations.

It is of particular significance to this study that the GWB explicitly applies to all undertakings which are either entirely or partly in public ownership or those which are managed or operated by public authorities[467] although the Deutsche Bundesbank and Kreditanstalt fur Wiederaufbau are specifically exempted from some of the provisions of the Act.[468] There is no special treatment for SOEs when they violate competition laws.

The Bundeskartellamt (Federal Cartel Office),[469] the Federal Ministry of Economics and Technology, and the cartel authorities of the sixteen German States[470] are responsible for enforcing the Act. Except for bid rigging, which became a criminal offence in 1997, committing any other restrictive practice remains an administrative offence only.[471] Germany like all other EU member states is subjected to the EU state aid rules.

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[466] HS Harris *Competition Law Outside the United States* (2001) 6.
See HL Buxbaum "German Legal Culture and the Globalization of Competition Law: A Historical Perspective on the Expansion of Private Antitrust Enforcement" (2005) 23(2) *Berkeley Journal of International Law* 474 474-495 for further reading on competition regulation in Germany after World War II.

[467] See section 130 of the German Act against Restraint of Competition (Gesetz gegen Wettbewerbsbeschrankungen).

[468] See section 130 of the German Act against Restraint of Competition (Gesetz gegen Wettbewerbsbeschrankungen).

[469] The Bundeskartellamt is responsible for enforcing the Act when the restrictive effect of the abusive practices "extend beyond one German state." See M Harris & HS Harris *Competition Laws outside the United States* (2001) 50. Section 49 (2) of the German Act against Restraint of Competition (Gesetz gegen Wettbewerbsbeschrankungen). See also JO Haley *Antitrust in Germany and Japan: The First Fifty Years, 1947-1998* (2017) 92-99.

[470] If the infringement of competition is only restricted to a particular German state, "the competition authority of that state will proceed against the infringement" M Harris & HS Harris *Competition Laws outside the United States* (2001) 50. Section 49 (2) of the German Act against Restraint of Competition (Gesetz gegen Wettbewerbsbeschrankungen).

[471] See C Vollmer "Experience with criminal law sanctions for competition law infringements in Germany" in KJ Cseres, M-P Schinkel & FOW Vogelaar *Criminalization of Competition Law Enforcement: Economic and Legal Implications for the EU Member States* (2006) 257 257.

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c) Statutory Competition Law in France

Wise states that the foundation for French competition law was laid during the French Revolution when the Chaplier Law of 1791 barred members belonging to the same trade community from assembling to regulate their own common interest.[472] This ended medieval restrictions on access to professions and commercial activities. The French Penal Code of 1810 also prohibited certain activities by coalitions or combinations and any price manipulations. Article 419 of the Penal Code[473] stated:

> "Those who, by false or slanderous reports, purposely spread among the people; or by offering higher prices than those which were asked by the venders themselves; or by coalitions or combinations among the principal holders of the same kind of merchandize or provisions, tending to prevent such goods being sold at all, or being sold under a certain price; or by any fraudulent ways or means whatever, shall have effected the enhancement or reduction of the price of provisions or merchandize; or of the public securities and stocks, above or below the prices which would have been determined by the free and natural competition of trade; shall be punished with an imprisonment of not less than one month, nor more than one year, and a fine of from 500 to 10,000 francs. The offenders may, moreover, be placed, by sentence or judgment, under the superintendence of the high police, during not less than two years, nor more than five years."

The penalty was doubled if any of the prohibited activities were applied in regard to specific products. Article 430 of the Penal Code 1810 stated:

> "The penalty shall be an imprisonment of not less than two months, nor more than two years, and a fine of from 1,000 to 20,000 francs, if such contrivances have been

[472] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 7; See also F Souty France "Competition Law Regimes in the World –A Civil Society Report", http://competitionregimes.com/pdf/Book/Europe/73-France.pdf and the OECD Reviews of Regulatory Reform in France: The role of Competition Policy in Regulatory Reform 7 http://www.oecd.org/regreform/32481170.pdf.

[473] The French Penal Code of 1810 can be accessed at: https://www.napoleon-series.org/research/government/france/penalcode/c_penalcode3b.html.

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> practiced upon corn, grain, flour, farinaceous substances, bread, wine, or any kind of liquor."

These restrictions were enforced by the Minister of Economic Affairs and Finance and the ministry's price directorate.[474] The restrictions on coalitions and combinations in both the Chaplier Law of 1791 and the Penal Code were only relaxed by the courts during the 1880s when they started to distinguish between "good and bad cartels."[475] Amendments to the Chaplier Law and the Penal Code in 1926 took into account the relaxation of the position in regard to combinations.[476] Combinations of manufactures, for example, could engage in certain activities such as division of markets and it was not necessarily condemned.[477] By the 1930s cartels were not seen as necessarily bad.[478] Riesenfeld states that "at some periods between the two world wars, concentration and cartelization were even fostered officially" and that the economic crisis during these times further strengthened "the status and role of the cartels."[479] Cartels were found in a number of industries which, inter alia, include the sugar industry, shoe manufacturing, high sea fisheries and the potassium industry.[480]

After World War II and before France became one of the founding members of the EEC, France enacted price control legislation.[481] A post-World War II Ordinance which was issued in 1945 made refusals to deal, price discrimination, resale price

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[474] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11; OECD Reviews of Regulatory Reform in France: The role of Competition Policy in Regulatory Reform 7
[475] GA Briefs "Cartels: Realism or Escapism?" (1946) 8 (1) *Review of Politics* 68 83; S A Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 576; M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 7 and OECD Reviews of Regulatory Reform in France: The role of Competition Policy in Regulatory Reform 7.
[476] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11. See also GA Briefs "Cartels: Realism or Escapism?" (1946) 8 (1) *Review of Politics* 68 83.
[477] SA Riesenfeld "The Legal Protection of Competition in France" 48 (4) (1960) *California Law Review* 574 577.
[478] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11.
[479] SA Riesenfeld "The Legal Protection of Competition in France" 48 (4) (1960) *California Law Review* 574 576-568.
[480] SA Riesenfeld "The Legal Protection of Competition in France" 48 (4) (1960) *California Law Review* 574 579.
[481] See RJA de Seife, "French and EEC Competition Law: GATT and U.S. Foreign Trade Policy Post-1992" (1992) 71 *Nebraska Law Review* 488 493.

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maintenance and reselling at a loss unlawful.[482] Since the Ordinance continued with price control measures such as those found in the Penal Code of 1810, it became known as the "Price Control Ordinance".[483]

An opportunity arose in 1953 to adopt a general competition law but the French Parliament failed to adopt the text.[484] The government instead issued a decree on the maintenance or re-establishment of free industrial and commercial competition.[485] It incorporated the Ordinance of 1945, added more concerted actions to those that were already unlawful[486] and led to regulation of some activities of combinations.[487] Riesenfeld states that besides adding new prohibitions, the 1953 decree also amended some of the already existing prohibitions such as (i) the prohibition on refusal to deal which was rephrased and extended; and (ii) the prohibition on maintenance of minimum prices which was expanded and the exceptions clarified.[488] The decree's most important provisions were found in article 59 bis, article 59 ter and article 59 quarter. Article 59 bis prohibited "[all] concerted actions, agreements, express or implied, understandings, or coalitions under whatever form or for whatever reason, which have as their object or may have as their effect the restriction of the full exercise of competition by placing an obstacle in the way of a lowering of production costs or sales prices or by favoring an artificial increase of the prices, are prohibited, except as provided in article 59 ter."[489] Article 59 ter stated that the prohibition in Article 59 bis does "not refer to the concerted actions, agreements or understandings: (1) Which result from the application of the

[482] F Jenny "France 1987- 1994" in E M Graham & J D Richardson (eds) *Global Competition Policy* (1997) 87 91 and M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11 and SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 582.
[483] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11.
[484] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11.
[485] Par 4 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.
[486] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11.
[487] SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 586
[488] SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 595.
[489] SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 595.

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text of a statute or regulation; (2) Which the originators are able to justify as having the effect of improving or extending the outlets of the production, or of assuring the development of economic progress by way of rationalization or specialization."[490] Article 59 quarter established an administrative agency, the Commission Technique des Ententes (Technical Commission for Restrictive Accords) which became responsible for investigating violations of article 59 bis.[491] Regardless of these new novel measures, the 1953 competition regime was mostly ineffective since firms continued to be involved in anticompetitive activities because the means to stop them were ineffective.[492] The blame for the state of affairs of the competition legislation in France during the years after World War II can be placed before the door of the government. It has been stated that "the French State has always … had a most irritating penchant for interventionism and a tendency to consider legislation on competition as simply one instrument amongst many for controlling the economy".[493]

Other amendments[494] followed in the years after the 1953 decree. In 1963 a law dealing with economic and financial stability which extended the application of competition law to the abuse of a dominant position and also extended the *Commission Technique des Ententes's'* powers to investigate any such abuse was adopted.[495] The additional powers which were allocated to the Commission caused it to be renamed as the *Commission Technique des Ententes et des Positions*

[490] SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 586.
[491] SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 595 and Para 3 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence 17-18 December 2014 http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD (2014)104&doclanguage=en.
[492] F Jenny "French Competition Policy in Perspective" in GW Comanor, K Jacquemin, A Jenny, F Kantzenbach, E Ordover & L Waverman (eds) *Competition Policy in Europe and North America* (1990) 146 146.
[493] I Roudard "The New French Legislation on Competition" (1989) 10(2) *European Competition Law Review* 205 205. See also the discussion on French SOEs in chapter two which indicates those periods during which France could be considered to have been a highly interventionist state.
[494] See SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48 (4) *California Law Review* 574 586 for these amendments.
[495] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 11; and Para 5 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.

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Dominantes ("Concerted Practices and Dominant Practices Commission").[496] Even with this change, the Commission continued to be only an advisory body.[497]

In 1977[498] another round of changes to French competition law followed. These changes took into account the changes that occurred on European level in regard to competition law such as the development of merger regulation.[499] At the time the EEC's competition framework was twenty years old.[500] In terms of the new changes, price controls were cut back, merger control was implemented, fines could be issued and injunctions granted for prohibited practices and the "Concerted Practices and Dominant Practices Commission was replaced with the *Commission de la Concurrence* ("Competition Commission").[501] Still, negative perceptions about the French competition system persisted.[502] It was described as "outdated", "full of contradictions", "cumbersome" and "dangerous".[503] The factors stated to contribute to this failure were (i) government intervention in markets, which included subsidization of industries, (ii) "centrally planned" restructuring of firms and (iii) the lack of a competition spirit in those French firms that were dealing in international markets.[504]

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[496] Para 5 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.

[497] Para 5 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.

[498] For more on these 1977 changes see F Jenny "Evolution of Antitrust Policies in France" in G Mussati (ed) *Mergers, Markets and Public Policy* (1995) 163 166.

[499] F Jenny "French Competition Policy in Perspective" in GW Comanor, K Jacquemin, A Jenny, F Kantzenbach, E Ordover & L Waverman (eds) *Competition Policy in Europe and North America: Economic Issues and Institutions* (1990) 146 151.

[500] For more in this regard see the discussions in para 4 4.3.7 of this chapter and par 3 of chapter 4 respectively

[501] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 12 and F Jenny "Evolution of Antitrust Policies in France" in G Mussati (ed) *Mergers, Markets and Public Policy* (1995) 163 167-168.

[502] See F Jenny "French Competition Policy in Perspective" in GW Comanor, K Jacquemin, A Jenny, F Kantzenbach, E Ordover & L Waverman, *Competition Policy in Europe and North America: Economic Issues and Institutions* (1990) 146 146. For further reading on the development of competition law in France after World War II see also SA Riesenfeld "The Legal Protection of Competition in France" (1960) 48(4) *California Law Review* 574 574-595.

[503] I Roudard "The New French Legislation on Competition" (1989) 10(2) *European Competition Law Review* 205 205.

[504] F Jenny "French Competition Policy in Perspective" in GW Comanor, K Jacquemin, A Jenny, F Kantzenbach, E Ordover & L Waverman *Competition Policy in Europe and North America: Economic Issues and Institutions* (1990) 146 146.

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As a result another round of fundamental change[505] to competition law were made in 1986, when France transitioned completely to a market economy. The changes were hailed as a "liberal reform".[506] Jenny states that the French government became at the time eager to show its commitment to a free market economy.[507] Hence, France adopted the 1986 Ordinance on price freedom and competition, which repealed the 1945 Price Ordinance.[508] The 1986 Ordinance was "hailed as a fundamental change in French economic policy."[509] Gerber states that this legislation was the "culmination of a process that had begun in 1977."[510] The new French competition law had "major symbolic importance for the role of competition law in Europe generally".[511] It led to the following changes to competition law in France:

(i) It abolished the price control system established in 1945 and competition amongst enterprises became the determinant for prices, with only some exceptions;[512]

(ii) It established the *Conseil de la Concurrence* ("Competition Council"), which unlike its predecessor, did not only have an advisory role[513] but was a "quasi-judicial" and independent body with investigative and decision-making powers.[514] The control of anticompetitive practices was transferred from the Minister Economics and Finances and the Competition Commission to the newly established agency and it became responsible for enforcing competition law. Companies could directly approach it, it could take legal action on its own initiative, impose injunctions and fines and make

[505] For more on these changes see I Roudard "The New French Legislation on Competition" (1989) 10 (2) *European Competition Law Review* 205 205.
[506] See RJA de Seife "French and EEC Competition Law: GATT and U.S. Foreign Trade Policy Post-1992" (1992) 71 *Nebraska Law Review* 488 494.
[507] F Jenny "Evolution of Antitrust Policies in France" in G Mussati (ed) *Mergers, Markets and Public Policy* (1995) 163 167-172.
[508] M Wise "Competition Law and Policy in France" (2005) 7 (1) *OECD Journal of Competition Law & Policy* 7 12; F Jenny "Evolution of Antitrust Policies in France" in G Mussati (ed) *Mergers, Markets and Public Policy* (1995) 163 167-172; and the OECD Reviews of Regulatory Reform in France: The role of Competition Policy in Regulatory Reform 8, http://www.oecd.org/regreform/32481170.pdf.
[509] D J Gerber *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (1998) 405.
[510] D J Gerber *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (1998) 404.
[511] D J Gerber *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (1998) 404.
[512] Examples include intervention when there is any limitation of competition through monopoly and when the French economy is affected by a crisis. See RJA de Seife "French and EEC Competition Law: GATT and U.S. Foreign Trade Policy Post-1992" (1992) 71 *Nebraska Law Review* 488 495.
[513] F Jenny "French Competition Policy in Perspective" in GW Comanor, K Jacquemin, A Jenny, F Kantzenbach, E Ordover & L Waverman, *Competition Policy in Europe and North America: Economic Issues and Institutions* (1990) 146 156.
[514] Para 8 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.

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recommendations to public authorities even in regard to draft legislative or regulatory texts;[515] and

(iii) The law on prohibited concerted practices and the abuse of a dominant position were not significantly changed.[516] There were however a few changes which, inter alia, included that (i) it became illegal for firms to exercise their economic bargaining power over other firms in ways which may have harmed competition, (ii) refusal to deal and price discrimination which became unlawful in terms of the Ordinance of 1945, were abandoned; and (iii) it decriminalized certain individual anticompetitive practices such as tie-in sales.[517]

Some issues remained however after the enactment of the 1986 Ordinance. One was that the Competition Council was only responsible for enforcing competition laws in regard to anticompetitive practices and dominance by enterprises. The Minister of Finance and Economic Affairs remained in charge of merger control with some involvement of the Council for Competition in cases where mergers could raise possible competition concerns.[518]

In 2001[519] the French competition law was "restated and codified."[520] The changes to competition law during this round, inter alia, included (i) a pre-merger notification

[515] Para 8 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.

[516] F Jenny "French Competition Policy in Perspective" in GW Comanor, K Jacquemin, A Jenny, F Kantzenbach, E Ordover & L Waverman, *Competition Policy in Europe and North America: Economic Issues and Institutions* (1990) 46 157.

[517] See RJA de Seife, "French and EEC Competition Law: GATT and U.S. Foreign Trade Policy Post-1992" (1992) 71 *Nebraska Law Review* 488 495-497.

[518] L Carswell-Parmentier "Reform of French competition law: adoption of a mandatory pre-merger control regime" (2002) 23 (2) *European Competition Law Review* 99 99-100.

[519] For more on all the 2001 changes to competition law see L Carswell- Parmentier "Recent developments in French competition law - commitments, leniency and settlement procedures - the French approach" (2006) 27 (11) *European Competition Law Review* 616 616-630 and N Jalabert-Doury "European and international competition" (2001) 5 *International Business Law Journal* 589 589-595.

[520] M Wise "Competition Law and Policy in France" (2005) 7(1) *OECD Journal of Competition Law & Policy* 7 12. For more on the 2001 law that brought the changes see S Lowe & M Perrier "The law on new economic regulations" (2001) 12(6) *International Company and Commercial Law Review* 183 183-186.

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requirement,[521] (ii) stronger sanctions for anticompetitive practices, and (iii) a provision for leniency.[522]

A further round of changes to the French competition law regime followed during President Sarkozy's administration.[523] In 2008 the Modernisation of the Economy Act 2008-776 led to an overhaul in regard to the enforcement of competition law.[524] It established the *Autorité de la Concurrence* (Competition Authority), the new agency responsible for enforcing competition legislation in France and it transferred merger control from the Minister of Finance and Economic Affairs to the Competition Authority.[525] Before this legislation was implemented, powers to enforce competition law were divided between the *Conseil de la concurrence* and the Ministry of Economy. Lassere states that the "transfer of merger control to the independent Authority [was] the flagship measure of the new regime."[526] The Ministry though retained some powers. These included:

(i) the power to request (but not require) that the Competition Authority carry out a full phase-two investigation with respect to a merger transaction which the Authority has approved in the abbreviated phase one,

(ii) the power to overrule, for general interest purposes, a decision by the Competition Authority if that would compensate for harm to competition, and

(iii) the power to enforce settlements in response to anticompetitive practices affecting "a market of a local dimension" in France.[527]

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[521] For more on the pre-merger notification procedure see L Carswell-Parmentier "Reform of French competition law: adoption of a mandatory pre-merger control regime" 2002 23(2) *European Competition Law Review* 99 99 -106; and J-P Robe "France: new French regulation in merger control" (2003) 9(1) *International Trade Law and Regulation* 3 3.

[522] M Wise "Competition Law and Policy in France" (2005) 7(1) *OECD Journal of Competition Law & Policy* 7 12.

[523] M Clough & D Slater "Current Developments in Member States" (2008) 4(1) *European Competition Journal* 319 342.

[524] B Lasserre "The New French Competition Law Enforcement Regime" (2009) 5(3) *Competition Law International* 15 15; and BL Peixoto, M Katz, E Kearney & L Pavic "International Antitrust" (2010) 44 *International Lawyer* 45 58-60.

[525] M Clough & D Slater "Current Developments in Member States" (2009) 5(3) *European Competition Journal* 847 862; B Lasserre "The New French Competition Law Enforcement Regime" (2009) 5(3) *Competition Law International* 15 15; BL Peixoto, M Katz, E Kearney & L Pavic "International Antitrust" (2010) 44 *International Lawyer* 45 58; and Para 14 OECD Roundtable on Changes in Institutional Design of Competition Authorities- Contribution by the French Autorité de la Concurrence.

[526] B Lasserre "The New French Competition Law Enforcement Regime" (2009) 5(3) *Competition Law International* 15 17.

[527] BL Peixoto, M Katz, E Kearney & L Pavic "International Antitrust" (2010) 44 *International Lawyer* 45 58-59.

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Recently two more laws changed France's competition law: the law on economic growth, activity and equal opportunities, also called the "Macron Law", since it was drafted by Emmanuel Macron (the current French President) while he was the Economy Minister, came into effect in August 2015[528] and Ordonnance 9 March 2017 (no 2017-303). Manuel Valls, the Prime Minister in Francois Hollande's administration, said of the changes brought by the "Macron Law": "The series of reforms designed to remove obstacles, free up initiatives and boost the return to growth continues. These are reforms that the French people have asked for and that will have a positive impact on their day-to-day lives and our economic health."[529] The changes made by these two laws included:

(i) for agreements between central purchasing bodies operating in the mass distribution sector to be notified to the Competition Authority two months prior to their entry into force when a certain threshold is reached [530]

(ii) simplification of leniency and settlement procedures.[531]

(iii) to help victims who are seeking compensation for anticompetitive behaviour which affected them, various presumptions have been made part of French competition law. Any anti-competitive practice against which the Competition Authority had to act, "now constitute irrebuttable evidence of infringement, triggering liability of the author of such practices to third parties."[532]

Today France's competition law is codified in the French Commercial Code.[533] Its competition law, like the competition law regimes of other EU member states, are closely aligned with EU competition law. There are some aspects though which are only found in French competition law and not in EU competition law. These include for example the prohibition on "Restrictive Trade Practices" which falls within the

[528] Law 2015-990. For Economic Growth and Activity and Equality of Economic Opportunities.
[529] See https://www.gouvernement.fr/en/law-on-economic-growth-and-activity.
[530] Article L. 462-10 as inserted the Macron Law article 37. Chapter 11:3 "An Overview of Competition Law in France" Corporate Counsel's Guide to International Antitrust" November 2017 Update.
[531] Article L. 464-2 as amended by the Macron Law article 218.
[532] Chapter 11:3 "An Overview of Competition Law in France" Corporate Counsel's Guide to International Antitrust" November 2017 Update. This new development in French competition law came as a result of the EU Directive 2014/10 on antitrust damages actions which was signed into law on 26 November 2014 and the deadline for implementing it in member states was 27 December 2016. The full Directive is accessible on (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.349.01.0001.01.ENG).
[533] Chapter 11:3 "An Overview of Competition Law in France" Corporate Counsel's Guide to International Antitrust" November 2017 Update.

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jurisdiction of the normal courts and not the Competition Authority.[534] The various pieces of legislation which were enacted over the years, firstly, to bring France's competition law in "agreement with modern thinking", secondly, to enable France to keep up with other European countries such as Germany, which also had to rebuilt their economies after the destruction of World War II and lastly, to keep up with greater European integration and convergence of national competition laws, thus ensured an effective and smooth transition from interventionist state to a free market economy.

4 3 7 4 Concluding remarks on EU statutory Competition law

Article 3 of the TFEU bestows exclusive competence on the EU in regard to the establishment of competition rules necessary for the functioning of the internal market. Since EU competition policy creates and maintains a fairer single market[535] which benefits consumers across all twenty eight member states, the EU Commission makes sure that competition policy is vigorously enforced. It wants to ensure that consumers do not pay more than they should for products or "have troubles finding the product they look for" and also that mergers do not harm the "competitive structure of the markets and thus consumers and the wider economy."[536]

To achieve this member states have to model their domestic competition laws on the primary legislation of the EU. This confirms the supremacy of EU competition law and avoid any possible conflict scenarios between EU competition law and domestic competition law, in which case EU law will trump domestic legislation because of the primacy principle which was establish by the Court of Justice in *Flaminio Costa v E.N.E.L.*[537] The competition authorities of the member states also assist the EU Commission in its endeavour to achieve a "fairer single market" hence they have

[534] Chapter 11:3 "An Overview of Competition Law in France" Corporate Counsel's Guide to International Antitrust" November 2017 Update.
[535] See the annual EU Commission report on Competition Policy of 2016 (available at http://ec.europa.eu/competition/publications/annual_report/2016/part1_en.pdf).
[536] The annual EU Commission report on Competition Policy of 2016 (available at http://ec.europa.eu/competition/publications/annual_report/2016/part1_en.pdf).
[537] *Flaminio Costa v E.N.E.L.* ECLI:EU:C:1964:66.

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concurrent powers with the EU Commission to make decisions relating to Articles 101 and 102 of the TFEU as well as enforcing their domestic competition legislation.

Even though a "United States of Europe", which Winston Churchill and other founding fathers of the EU had in mind after World War II, could not be achieved as each member state of the EU remains an individual nation-state, competition law within the EU is in broadly similar position to the federal antitrust laws of the United States within each EU member state, due to the supremacy of EU law. Also, because of the principles of "direct applicability" and "direct effects" any new developments in regard to EU competition law, becomes directly applicable in member states.[538] EU statutory competition law might not be as old as the antitrust laws of the United States,[539] but today these two competition law regimes have almost the same degree of influence throughout the world.

4 3 8 Statutory Competition law in post-Apartheid South Africa[540]

4 3 8 1 Introduction

The Constitution[541] of the Republic of South Africa, 1996 determines that:

> "Every citizen has the right to choose their trade, occupation or profession freely. The practice of a trade, occupation or profession may be regulated by law."

In *Phumelela Gaming and Leisure Limited v Grundlingh*[542] the Constituional Court of South Africa stated that:

[538] J Steiner & L Woods *EU Law* (2009) 105.
[539] See the discussion above in this chapter on the United States antitrust laws.
[540] This part will only discuss the applicability of South Africa's competition law to the economic activities of SOEs. The issue of possible distortive state aid to SOEs in South Africa and how this may impact on competition will be discussed comprehensively in chapter 5.
[541] Section 22 of the Constitution.
[542] (CCT3105) [2006] ZACC 6 para 36. See also the reference to this case in para 2.3.1 of chapter 5.

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> "The Bill of Rights does not expressly promote competition principles, but the right to freedom of trade, enshrined in section 22 of the Constitution is, in my view, consistent with a competitive regime in matters of trade and the recognition of the protection of competition as being in the public welfare"

The constitutional provision above and the statement by the Constitutional Court, together with legislation such as the Competition Act, strengthen South Africa's "free enterprise economic system". As is the case with all market economies around the world, competition amongst enterprises with little or no state intervention, forms the cornerstone of the economy.[543] Or as stated by Judge Van Zyl in *Heyneman v Waterfront Marine CC*:[544]

> "In any free enterprise economic system or, as it is usually called, "free market economy", it is generally accepted that entrepreneurs and participants in the commercial sphere are free to compete with one another"; and
>
> "…competition is, generally speaking, said to be of benefit to all interested parties, including the national interest."

Competition amongst enterprises in South Africa has no doubt played an important part, if not the most important part, in South Africa's economic development, which is why competition has been described as the "life blood of commerce".[545] In post-Apartheid South African competition is regulated by the Competition Act.

4 3 8 2 The Competition Act

> **"**The Act prohibits practices that may eliminate competition in any market within South Africa's economy. It also forbids abuse of dominance by business entities. The Act, through the enforcement of these prohibitions, encourages and

[543] For further reading see J Neethling, *Unlawful Competition* (2008) 1-14.
[544] [2005] 2 All SA 382 (C) 397-398.
[545] See *Taylor & Horne (Pty) Ltd v Dental (Pty) Ltd* [1991] 2 All SA 3 (A) 7.

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> promotes competition in markets for the benefit of consumers of goods and services."[546]

Democracy in 1994 led to substantial changes of South Africa's competition policies. The ANC[547] noted that:

> "The concentration of economic power in the hands of a few conglomerates has been detrimental to balanced economic development in South Africa. The ANC is not opposed to large firms as such. However, the ANC will introduce anti-monopoly, anti-trust and mergers policies in accordance with international norms and practices, to curb monopolies, continued domination of the economy by a minority within the white minority and promote greater efficiency in the private sector."

Hence the Department of Trade and Industry (DTI) prioritised the implementation of a new competition law as it felt there were a number of substantive reasons for adopting such a new law. Firstly, the Maintenance and Promotion of Competition Act 96 of 1970[548] which regulated competition in South Africa before the democratic dispensation, was deficient and lacked "adequate powers and proper political context"[549] and the DTI wanted to "align competition law with trade and industrial policy and with the treatment of public enterprises",[550] secondly, the Act did not address the extent of concentration of ownership or market share, thirdly, there was no regulation of vertical or conglomerate mergers, fourthly, there was little effort to prevent mergers and acquisitions which intensify concentration and lastly, there were no strong prohibitions of anti-competitive activity.[551] The DTI argued that the competition policy reforms, apart from its importance for economic and social reform,

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[546] *Competition Commission of South Africa v Senwes Limited* 2012 7 BCLR 667 (CC) 669.
[547] See the "ANC policy guidelines for a democratic South Africa" (accessible at http://www.anc.org.za/docs/pol/1992/readyto.html).
[548] For detailed reading on this act and the competition policy enforcement during the time when this act was still active legislation see D Prins & P Koornhof "Assessing the nature of competition law enforcement in South Africa" (2014) 18 L*aw, Democracy and Development* 39 39-140.
[549] See Competition Policy in South Africa: An OECD Peer Review (accessible at https://www.oecd.org/daf/competition/prosecutionandlawenforcement/2958714.pdf).
[550] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 26.
[551] Proposed Guidelines for Competition Policy: A framework for competition, competitiveness and development (Department of Trade and Industry 1997).

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were also prudent for South Africa's reintegration into the global economy, after years of isolation due to its Apartheid policies.

Hence new and comprehensive competition legislation was implemented in South Africa in the form of the Competition Act 89 of 1998, which repealed the Maintenance and Promotion of Competition Act as a whole. The Competition Act received presidential assent on 20 October and came into effect on 30 November 1998 although many of its provisions only came into effect on 1 September 1999.[552] Lewis observes that during the negotiations for the new competition regime "secretiveness and a profound lack of accountability" was at the order of the day in the South African business sector.[553] On the one hand there was the newly democratically elected ANC-led government which had its own plans for South Africa's economy and on the other hand there was a business sector dominated by businesses which were the remains of the Apartheid era. These businesses had no choice but to start cooperating with the authorities. The first decade of the new competition law dispensation was, for the most part, successful.[554] Regulated competition in South African now gives not only a minority group of South Africans the opportunity to choose between services and goods with competitive prices within markets but all South Africans are now afforded such privileges.

With the implementation of the Competition Act South Africa followed developed countries that have progressive competition laws and policies. The Competition Act thus brought South Africa's competition legislation into line with international trends. The implementation of the Competition Act was of such significance for South Africa's economic development that it has prompted Lewis to state that "a competition culture has taken root in very infertile soil" and that the Competition Act and those institutions established by it has been a "highly successful enterprise".[555] The Competition Act established the Competition Commission, Competition Tribunal

[552] It has been described as a "central feature of democratic process". See D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 9.
[553] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 1.
[554] The success is illustrated by the many cases of anticompetitive practices investigated by the Competition Commission and also those cases which came before the adjudicating competition agencies. All successes through investigations and adjudication have shown that the competition authorities successfully enforce the Competition Act.
[555] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 3-4.

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and the Competition Appeal Court, which are the institutions responsible for enforcing the competition laws of the country. The South African competition authorities, through their effective protection of competition have earned the respect of business people, government, organised labour and their international peers.[556]

4 3 8 3 The purpose of the Competition Act

Economic efficiency is at the centre of the new competition law regime. However, social development was not disregarded when the legislature drafted the new competition legislation. The Competition Act provides a comprehensive description of the purpose of the Act. Section 2 of the Competition Act states that the purpose of the Act is:

> "to promote and maintain competition in the Republic in order—
>
> (*a*) to promote the efficiency, adaptability and development of the economy;
>
> (*b*) to provide consumers with competitive prices and product choices;
>
> (*c*) to promote employment and advance the social and economic welfare of South Africans;
>
> (*d*) to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;
>
> (*e*) to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and
>
> (*f*)

[556] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 3.

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> to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons."[557]

Not only does this purpose clause reflect the economic reasons for the new competition dispensation, it also includes a number of "public interest objectives" by giving expressly priority to goals that goes beyond the orthodox goals of competition law.[558] Although promotion of employment and the other non-traditional goals which are part of South African competition law are not unique to South Africa's competition legislation, they are not often found as objectives in competition legislation around the world. Such goals are in particular not in the competition legislation of those jurisdictions which have been discussed in this chapter. The South African legislature obviously had its reasons why objectives which are not "core competition objectives" had to be promoted by South African competition law.

What was then the reason why South Africa has opted for this approach to competition law? This question is particularly important since the acceptance of wider goals has certain negative consequences for South African competition law. These goals broaden the mandate of the competition authorities and increase the complexity of their task. Not only do they have to determine whether actions will reduce efficiency or harm consumers but they have to determine the consequences in a much wider sense. It may be argued that many of these goals should be pursued through other policy instruments. From a social perspective, however, the South African approach can be justified. The Competition Act came into effect at the time of the transition from Apartheid to democracy. It is aimed at addressing the evils of the Apartheid economy which was designed to benefit the white minority only. The Apartheid economy created one of the most unequal societies in the world with very high levels of structural unemployment as well as high poverty levels. The unemployment rate in the first quarter of 2018 stood at a staggering 26.7 percent[559] and poverty levels continue to rise. Moreover, small and medium enterprises (SMEs) continue to face challenges as participants of the South African economy, even

[557] See Section 2 of the Competition Act 89 of 1998.
[558] See the discussion in *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) para 92.
[559] See http://www.statssa.gov.za/?page_id=737&id=1 (accessed on 10 August 2015).

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though they contribute significantly to "job creation, poverty alleviation and assisting in the prosperity of the nation"[560] and historically disadvantaged people still only own an insufficient part of productive assets in the economy. Although employment creation, assisting SME's in their development and the correction of the economic imbalances of the past are not traditional competition goals, they can only be successfully addressed when there is an efficient economy which works for all and not a limited few. These gloomy realities justify the wider goals of post-Apartheid competition law even though the prominence of public interest goals of competition law in South Africa is not new.[561] South Africa thus followed an approach to competition law which would meet its developmental demands even though competition law generally deals with the efficiency of an economy and not necessarily "development demands".[562] The Competition Act thus has to promote "core competition objectives", those objectives that are typically part of any competition law all over the world and "social and industrial policy objectives", those objectives which South Africa wanted as a specific part of its competition law.[563]

The Constitutional Court has acknowledged that some of the Competition Act's objectives are directed at addressing the inequalities and imbalances which were created by Apartheid.[564] It stated that:

> "Section 2(e) and (f) of the Competition Act states that part of the purpose of the Competition Act is to ensure that small and medium sized businesses have equitable opportunities to participate in the economy and to promote a greater spread of ownership in the economy by those who were disadvantaged by Apartheid. These purposes implicate the right of equality contained in section 9 of the Constitution. Section 9(2) enjoins the State to take legislative and other measures to advance the

[560] For more on the challenges faced by SMEs in South Africa see ST Leboea *The Factors Influencing SME Failure in South Africa* M.Com UCT (2017).
[561] Under the Maintenance and Promotion of Competition Act 1979 public interest played an imperative role when decisions had to be made by the Competition Board, which is the predecessor of the Competition Commission, on whether a restrictive practice or acquisition was justified of not. It was described as the "final criterion" for the justification or not of a restrictive practice or acquisition. See FCN Fourie "Issues and Problems in South African Competition Policy" (1987) 55(4) *South African Journal of Economics* 334 334.
[562] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 27.
[563] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 28.
[564] *Competition Commission of South Africa v Senwes Limited* 2012 7 BCLR 667 (CC) 669.

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> equality of previously disadvantaged people and section 2(e) and (f) of the Competition Act is a legislative measure of this kind".[565]

This approach of South Africa to the goals of competition law has not gone unchallenged. It is questioned whether competition law as set out in the Competition Act could reasonably meet all these goals.[566] Reekie is of the opinion, firstly that the promotion of employment should not be a matter for competition policy but for macroeconomic policy. The author argues that if employment promotion is given the necessary importance by the competition authorities, the result could be possible reduced efficiency.[567] This is the opposite of what competition law normally should achieve. Secondly, it is stated that competition law is not the "appropriate forum" for correcting past injustices by including the promotion of "a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons" as a purpose of competition law.[568] Reekie justifies this observation by saying that redistribution should be either addressed through fiscal measures or "by restructuring state assets".[569] Thirdly, it is stated that if competition law is focused on matters such as the social welfare of all South Africans and the expanding of opportunities for South Africans to participate in world markets, it may have the opposite effect of promoting "the efficiency, adaptability and development of the economy" and "to provide consumers with competitive prices and product choices".[570] And lastly, it is stated that an already difficult task of the competition authorities is made even more difficult by including these "non-competition" goals as purposes of the Act.[571]

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[565] *Competition Commission of South Africa v Media 24 (Pty) Limited* (CCT90/18) [2019] ZACC 26 (3 July 2019) para 30-31.
[566] See WD Reekie "The Competition Act, 1998: An Economic Perspective" (1999) 67(2) *South African Journal of Economics* 258 258.
[567] WD Reekie "The Competition Act, 1998: An Economic Perspective" (1999) 67 (2) *South African Journal of Economics* 258 258.
[568] WD Reekie "The Competition Act, 1998: An Economic Perspective" (1999) 67 (2) *South African Journal of Economics* 258 258.
[569] WD Reekie "The Competition Act, 1998: An Economic Perspective" (1999) 67 (2) *South African Journal of Economics* 258 258.
[570] WD Reekie "The Competition Act, 1998: An Economic Perspective" (1999)67 (2) *South African Journal of Economics* 258 258.
[571] WD Reekie "The Competition Act,1998: An Economic Perspective" (1999) 67(2) *South African Journal of Economics* 258 259.

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Practical implementation of the broad goals of the Competition Act was never going to be easy for the competition authorities of South Africa. The importance and perhaps difficulties of having the public interest goals as part of the Competition Act came under the spotlight when the Competition Tribunal approved the Massmart and Walmart merger by finding that the merger would not prevent or lessen competition in any of the markets in which Massmart operated. The Tribunal however imposed conditions because of public interest concerns, which the Tribunal described as "one of the unusual features" of the Competition Act. Although the non-traditional goals in section 2 of the Competition Act was not the focus in this matter as section 12A (3) of the Act provides a separate list of specific public interest considerations which form part of merger analyses, employment considerations and the creation of opportunities for small and medium businesses in a competitive environment is also important just like in section 2.

Despite an absence of competition concerns, a "pro-competitive" merger in South Africa may still be prohibited on public interest grounds. However, public interest is not open-ended and is limited to four factors. The competition authorities may only consider the effect of the merger on (i) a particular industrial sector or industry; (ii) employment; (iii) the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive; and (iv) the ability of national industries to compete in international markets.[572] The Competition Tribunal in the Massmart and Walmart merger imposed conditions to protect these interests. Firstly, the merged entity had to ensure that there were no retrenchments based on operational requirements in South Africa, resulting from the merger, for a period of two years from the effective date of the transaction. Secondly, the merged entity had to give preference to previous employees who were retrenched in 2010, should any employment opportunities become available within the entity. Thirdly, the merged

[572] *Walmart Stores Inc and Massmart Holdings Limited*, Case No: 73/LM/Nov10 and *Minister of Economic Development/ Competition Tribunal; South African Commercial, Catering andAllied Workers Uni on / Walmart Stores Inc* [2012] 1 CPLR 6 (CAC). See Section 12A(1)(*b*) of the Competition Act which provides that: "When determining whether a merger can or cannot be justified on public interest grounds, the Competition Commission or the Competition Tribunal must consider the effect that the merger will have on—
(*a*) a particular industrial sector or region;
(*b*) employment;
(*c*) the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive; and
(*d*) the ability of national industries to compete in international markets."

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entity had to honour any existing labour agreements and could not challenge the position of the largest representative union, the South African Commercial Catering and Allied Workers Union (SACCAWU), within the merged entity, for at least three years from the effective date of the transaction. Lastly, the merged entity had to establish a programme aimed exclusively at the development of local South African suppliers.

The competition authorities in South Africa thus have to balance public interest with the standard competition considerations. The primary consideration is whether the merger harms competition and public interest is considered as a secondary aspect. Nevertheless, the competition authorities have not received much guidance from the Competition Act on how strict competition and public interest aspects have to balance.[573] The competition authorities have thus considerable discretion when deciding the impact of public interest. The Competition Tribunal observed that public interest must be assessed with caution when dealing with a pro-competitive merger.[574] It further stated that the public interest mandate should not be pursued in an "over-zealous" manner.[575]

Scholars questioned whether it was appropriate for the competition authorities to impose conditions as was done in the Walmart case.[576] The conditions regarding the continuation of employee contracts is not really open to question as merger approvals often require the merged entity to continue existing contracts for a certain time.[577] What was however criticised was the condition which required that the merged entity continue to honour existing labour arrangements with Massmart's (one

[573] See *Shell South Africa (Pty) Ltd/Tepco Petroleum (Pty) Ltd* 66/LM/Oct 06 (CT). See also DM Davis "The Development of Competition Law and Economics in South Africa" (2014) 131 (3) *South African Law Journal* 712 713, where DM Davis, the President of the Competition Appeal Court, praises the authors of the book which he reviewed for noting that there is little assistance which can be borrowed from other competition jurisdictions on "how to balance issues of public interest with standard cognisable competition considerations."
[574] See *Shell South Africa (Pty) Ltd/Tepco Petroleum (Pty) Ltd* 66/LM/Oct 06 (CT).
[575] See *Shell South Africa (Pty) Ltd/Tepco Petroleum (Pty) Ltd* 66/LM/Oct 06 (CT) where the Competition Tribunal stated as follows: "The role played by the competition authorities in defending even those aspects of the public interest listed in the Act is, at most, secondary to other statutory and regulatory instruments [….].The competition authorities, however well intentioned, are well advised not to pursue their public interest mandate in an over-zealous manner lest they damage precisely those interests that they ostensibly seek to protect."
[576] J Staples, M Holland & J Rossouw "Taking Public Interest Too Far: Walmart Stores Inc v Massmart Holdings Ltd*"* (2013) 25 *South African Mercantile Law Journal* 94 95.
[577] J Staples, M Holland & J Rossouw "Taking Public Interest Too Far: Walmart Stores Inc v Massmart Holdings Ltd*"* (2013) 25 *South African Mercantile Law Journal* 94 99.

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of the merging entities) largest representative trade unions for a three year period, since such a condition was not "merger-specific".[578] It is further argued that labour institutions and legislation should rather be used for labour issues that are not related to a specific merger and that competition authorities should not intrude on labour issues during their assessments of mergers unless such issues arise from the merger.[579]

The matter came before the Competition Appeal Court (CAC) for an appeal against the Tribunal's decision to allow the merger (and a review[580] of the Tribunal's proceedings). For purposes of this particular discussion, those issues raised in regard to the appeal are most significant. In the appeal it was contended that in adopting a consumer welfare standard exclusively, to the exclusion of other "societal welfare" factors, the Tribunal and the merging parties "ignored the express language of the [Competition] Act".[581] It was further contended that section 12A[582] "enjoins the competition authorities to take account of factors which do not play a role in terms of the consumer welfare approach to competition policy" as the section established "a new paradigm".[583] The CAC stated that the Competition Act seems to require the Tribunal to initially examine the merger transaction within a traditional consumer welfare standard.[584] Only thereafter the Tribunal will continue with its broader inquiry

[578] J Staples, M Holland & J Rossouw "Taking Public Interest Too Far: Walmart Stores Inc v Massmart Holdings Ltd" (2013) 25 *South African Mercantile Law Journal* 94 99.
[579] J Staples, M Holland & J Rossouw "Taking Public Interest Too Far: Walmart Stores Inc v Massmart Holdings Ltd" (2013) 25 *South African Mercantile Law Journal* 94 98.
[580] For the sake of completeness, short reference is made to those matters that were on review. The review was directed against the Tribunal's scheduling of the matter and how discovery of documents took place. In making its decision the CAC used the test whether the Tribunal's discovery order and scheduling decisions are decisions which a reasonable decision maker could not make. In regard to both the Tribunal scheduling decisions and the discovery of documents during the Tribunal proceedings, the CAC stated that the reasonable decision-maker would have made the same decision.
[581] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 29.
[582] Section 12A (3) in particular, requires the Tribunal when determining whether a merger can or cannot be justified on public interest grounds to consider specific public interests. These are the effect of the merger on "(a) a particular industrial sector or region; (b) employment; (c) the ability of small business, or firms controlled or owned by historically disadvantaged persons, to become competitive; and the ability of national industries to compete in international markets."
[583] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 29-30.
[584] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 31.

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in terms of sections 12A (2) and 12A (3).[585] It accepted that a standard other than consumer welfare would "complicate the implementation of the Act, particularly owing to the complexity of the economic calculation of total welfare of a particular transaction"[586] but also noted that "a narrow view of consumer welfare determined exclusively in terms of [effects] upon price and output" is not what the Competition Act mandates.[587]

In regard to the question as to what weight should be given to those specific public interests listed in section 12A(3) of the Competition Act in order to determine whether it should trump a finding based on "traditional considerations of consumer welfare", the CAC[588] said the following:

(i) As a result of the structure (and wording) of section 12A, the Tribunal or the CAC may be faced with arguments on consumer welfare and arguments that extend to employment and the interest of small business.[589]

(ii) As such a proportionality exercise is required to determine how to balance the competing arguments. And even though this process might never be precise, it is what the Competition Act requires since the competition authorities have to proceed to engage with the factors which make up the public interest inquiry, even after they found that the merger is not likely to substantially prevent or lessen competition.[590]

(iii) But a proportionality exercise "requires evidence which would enable the exercise, justify the calculation which flows therefrom and permit a balance to be struck between the competing issues of consumer welfare employment and small

[585] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 31.
[586] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 31.
[587] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 32.
[588] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 32.
[589] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 32-33.
[590] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 32-33.

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business." A lack of precise evidence[591] however would make it difficult to do the proportionality exercise.[592]

(iv) Therefore section 12A intends that when there is a finding that the merger will not substantially prevent or lessen competition, it should only be prohibited if there are "clearly identified, substantial public interest grounds" and if the effect on those specific public interests in section 12A (3) is not substantial, the court cannot use the public interest test to disallow the merger. [593]

(v) In accordance with all the evidence which was available to the Tribunal there was no reason to conclude that those public interest considerations[594] raised in the appeal should trump the benefits which consumers got from the merger and as a result disallow the merger.[595]

The CAC concluded by amending some of the conditions which the Tribunal imposed on the merging parties. The CAC required the merged entity to reinstate the retrenched workers while the Tribunal only wanted them to receive preference should employment opportunities arise within the merged entity. It also commissioned a study funded by the merging parties to establish the most appropriate means and mechanisms to empower local suppliers to respond to the

[591] The lack of sufficient evidence in this case made it difficult to determine whether any job losses caused by an increased importation of goods outweigh the consumer benefits.

[592] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 32-33.

[593] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 36.

[594] In this case these interests included the rights of employees in the merged entity, the position in regard to those employees that were retrenched and the impact of the merger on the domestic supply chain including SMMEs. In regard to employee rights the CAC questioned whether it is "the role of competition law to provide the specific safeguards sought" by the trade union in regard to the employment rights of employees after the merger. It said that if the merging parties would seek to erode union or employee rights guaranteed under existing law, these will be protected by the Labour Courts, which are set up to deal with disputes of rights. In regard to the retrenched employees the CAC said that "a retrenchment, which takes place shortly before the merger is consummated may raise questions as to whether this decision forms part of the broad merger decision-making process." This could require the merging parties to justify the retrenchment. In regard to the impact of the merger on the domestic supply chain and small and medium businesses, the CAC stated that "competition law cannot be a substitute for industrial or trade policy; hence this Court cannot construct a holistic policy to address the challenges which are posed by globalisation. But the public interest concerns set out in section 12A demands that this Court gives tangible effect to the legislative ambition." The CAC felt that the Tribunal did not engaged meaningfully with the impact of those challenges posed by globalisation on small and medium businesses in South Africa. Hence the CAC instructed the merging parties to commission a study to investigate the implications of the merger for small and medium size businesses. *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 41-43.

[595] *Minister of Economic Developments/Competition Tribunal; South African Commercial, Catering and Allied Workers Union/ Walmart Stores Inc* [2012] 1 CPLR 6 (CAC) 37.

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challenges that were posed by the merger. It is submitted that it is not often that the CAC makes a decision on the reinstatement of retrenched employees, something which is generally associated with labour courts and not competition courts, unless of course it is merger related, as was the case in this matter.

The above discussion has shown that the non-traditional goals in section 2 of the Competition Act together with those specific public interest considerations in section 12A (3) require the South African competition authorities to go much further than many of their counterparts around the world when adjudicating competition matters. South Africa should however guard against over-use of competition law as a tool to achieve wider goals. Other measures should be put in place to do so. Competition policy should continue to focus on what competition should ultimately achieve, which is a free and fair economy within which enterprises of all sizes may flourish and from which all South Africans benefits by having choices between quality products and services.

4 3 8 4 Applicability and types of behaviour regulated by the Competition Act

The Competition Act applies "to all economic activity within, or having an effect within, the Republic", with certain exceptions.[596] It prohibits restrictive horizontal practices,[597] restrictive vertical practices,[598] abuses of dominance[599] and price

[596] Such exceptions include (i) collective bargaining within the meaning of section 23 of the *Constitution*, and the Labour Relations Act, 1995 (Act No. 66 of 1995), (ii) a collective agreement, as defined in section 213 of the Labour Relations Act, 1995 and concerted conduct designed to achieve a non-commercial socio-economic objective or similar purpose. See Section 3 of the Competition Act 89 of 1998.

[597] See section 4 of the Competition Act .These are practices between enterprises which operate on the same level in the market and are thus competitors. The following practices are prohibited: agreements, concerted practice or decisions between firms or an association of firms in a horizontal relationship which may substantially prevent of lessen competition in a market unless any advantages such as technological, efficiency or other pro-competitive gain resulting from such behaviour outweighs the effect. Such agreements, concerted practices or decisions between enterprises may end in price fixing, market division and collusive tendering. The Act, in certain circumstance, also makes provision for a rebuttable presumption in regard to the existence of a restrictive horizontal practice.

[598] See section 5 of the Competition Act. This provision concerns enterprises operating their business on different levels of a supply chain such as a firm and its suppliers. An example of behaviour prohibited in this regard is the practice of minimum resale price maintenance even though a resale price may be recommended by a supplier or producer to a reseller but subject to certain restrictions.

[599] See sections 6 to 9 of the Competition Act. A firm is presumed to be dominant if certain conditions are present. These are if a firm has at least 45% of a market or if it has at least 35% of a market but less than 45% unless the firm can show that it has not market power or if a firm has less than 35% of the market but it has market power.

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discrimination by a dominant firm.[600] The Act also establishes a comprehensive merger control system[601] which is enforced by the competition authorities. A merger occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm.[602] Parties to an intermediate or large merger are required to notify the Competition Commission of the merger within the prescribed period,[603] while a party to a small merger is not required to notify the Competition Commission of that merger unless the Commission requires it to do so.[604] The Act and regulations enacted in terms of it determine the thresholds for small, intermediate or large mergers.[605]

4 3 8 5 Competition law and SOEs in South Africa

As with its citizens, the South African government performs economic activities. This is not something novel since States all around the world take part in economic activities. State organs are parties to contracts and States establish corporate entities that participate in the economy in the form of SOEs.

There are many reasons why the state would participate in the economy which include: socio-economic development, market failure in a sector and accessibility to goods and services for all. Many activities which the State undertakes are important for socio-economic reasons.[606] A state will have a strong incentive to participate in sectors of the economy which are crucial for the development and maintaining of an efficient economy and the fair distribution of resources but are perceived not to be properly served by private firms. A government can act as a "market maker" by deciding to open up competition within markets where goods and services were previously only supplied by the public sector or it can act as a market participant through, for example, an SOE to supply services and goods that "free markets are

[600] See section 9 of the Competition Act.
[601] See sections 11- 18 of the Competition Act.
[602] Section 12 of the Competition Act.
[603] See chapter 3 of the Competition Act. See also *Distillers Corporation (SA) Ltd v Bulmer (SA) (Pty) Ltd* [2001–2002] CPLR 36 (CAC) which highlights the approach to sections 12 and 13.
[604] Section 13 of the Competition Act.
[605] Section 11 of the Competition Act.
[606] See the comprehensive discussion in para 1.2 of chapter 2 for the reasons why governments use SOEs.

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unlikely to supply at an adequate level."[607] There accordingly are good reasons why the South African state participates in the developing and transitional South African economy that was ravaged by the discriminatory policy of apartheid.

SOEs and private enterprises in South Africa conduct their activities in the same economic sphere.[608] Competition policy pursues a level playing field for all firms, irrespective of their ownership. Nevertheless, this may be difficult in markets where SOE's participate. SOEs are hybrid institutions that are used to achieve socio-economic development but are also commercial enterprises. Although they perform economic activities they have the regulatory and financial might of the state behind them. Page states that "state regulation and antitrust really have the same goal of promoting the public interest; antitrust establishing the general competitive rules and the states intervening to displace competition in cases of clear-cut market failure."[609] But intervention by the state will distort markets and it may in reality be difficult to decide when public interest would be best served by market forces or by government interventions that distort markets. There will have to be limits on the extent to which the state should be allowed to intervene in markets.

In order to prevent distortions of the competitive process, the state as a market participant should, as a point of departure, be subject to competition law. Section 81 of the Competition Act is an expression of this general principle. Section 81 of the Competition Act states that the "Act binds the State" and consequently the Competition Act is also applicable to economic activity by the State. Since SOEs are engaging in "economic activity" the Competition Act is applicable to them.[610] Nevertheless, there are important limitations when it comes to the reach of competition law in the context of the state. First, the Competition Act is an ordinary Parliamentary statute. Later legislation may override it.[611] Even though certain

[607] See TK Cheng, I Lianos & DD Sokol, *Competition and the State* (2014) 3.
[608] See the Proposed Guidelines for Competition Policy: A framework for Competition, Competitiveness and Development by the Department of Trade and Industry (27 November 1997).
[609] WH Page "State action and "active supervision": an antitrust anomaly" (1990) 35 (3) *Antitrust Bulletin* 745 747.
[610] See the discussion in para 3.2 of chapter 2 on the role of SOEs in South Africa.
[611] See for example section 22(G) of the Medicines and Related Substances Control Act 101 of 1965 which provide for a transparent pricing system for all medicines and related substances in South Africa and no

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activities may possibly impact on competition, for reasons mentioned above those activities may be exempted from competition law and will thus not fall within its ambit. Secondly, many practices by which the state can distort competitive processes will not be covered by the ordinary provisions of competition. Most importantly, the granting of state aid will fall into this category. The need for regulating state aid in South Africa will be fully canvassed in chapter 5. In order to avoid the distortion of competition by the granting of state aid, chapter 5 provides proposals for regulation of the granting of state aid to economically engaged SOEs. That chapter will propose that certain state aid should be subjected to scrutiny in order to ensure a fair playing field for all those entities which are economically active in South Africa. The regulation of state aid, as recommended in chapter 5, may also promote goals that are at best indirectly related to competition such as addressing the failures of governance[612] and financial management in SOEs and ensuring the application of government funding for the welfare purposes for which they are allocated to SOEs. It is however not the intention to propose in that chapter that state aid to SOEs should be prohibited under all circumstances. Such a suggestion will deny many exceptionally important mandates and developmental goals of SOEs in a society like South Africa, which still suffers the consequences of previous discriminatory laws. The mandate and socio-economic need for the existence of a particular SOE and the broad aims of the Competition Act should be balanced in order to determine the appropriateness of any state aid.

4 3 8 6 Concluding remarks on South African statutory competition law

The Competition Act is an important piece of legislation since it was part of the economic policies that brought South Africa out of its "isolationist past".[613] It is a post-Apartheid policy tool which was meant to ensure that the South African

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pharmacist, wholesale or distributor of such medicine and substances is allowed to sell it at a higher price than the price that was set by the pricing committee.

[612] Governance failures and absence of good financial management in SOEs are comprehensively discussed in para 1.2 of chapter 5.

[613] See for example G Makhaya, W Mkwananzi & S Roberts "How should young institutions approach competition enforcement? Reflections on South Africa's experience" (2012) 19 (1) *South African Journal of International Affairs* 43 43-64.

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economy benefits all South Africans and not only a few.[614] Since its inception in 1999, the Competition Act did well in protecting competitive processes for the benefit of consumers but also in order to promote other objectives. It has been successful because it has been vigorously enforced. The Competition Act also applies to the economic activities of SOEs and it has been vigorously applied to these institutions. By including these economic activities in the scope of the Competition Act, South Africa has kept abreast with advanced competition law jurisdiction, in particular developed countries.[615] However, it is argued that the current scheme for regulating the activities of SOEs is incomplete. It is not sufficiently recognised that competition can be harmed by state activities in regard to these SOEs which are not necessarily economic activities. In this respect, South African competition law accords with most other regimes outside of the EU. However, it is proposed that the major role which these entities play in the South African economy justifies a rethink. It is submitted that if the recommendations about the regulation of state aid that are made in chapter 5 are accepted, South Africa's competition law regime will be able to realise the objectives set out in the Competition Act.

END OF CHAPTER

[614] See D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2012) 1- 281 for a comprehensive discussion of the Competition Act.
[615] See the discussion above in this chapter on the position within EU countries and the US.

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CHAPTER 4: STATE AID REGULATION IN COMPETITION LAW: THE EUROPEAN UNION EXAMPLE[1]

[1] In this chapter, unless otherwise indicated, the numbering of the state aid rules in the treaties currently in force is used. Since the state aid rules as contained in the founding treaties have been renumbered on numerous occasions, it is only sensible to use the numbering in the treaties currently in force. The EU state aid control regime is at present found in Articles 107-109 of the TFEU. Previously it was numbered as Articles 87-89 by the Amsterdam Treaty, while in the founding EEC Treaty the state aid rules were found in Articles 92-94. Certain discussions however require that the numbering in the EEC Treaty or the Amsterdam Treaty is referred to.

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1 Introduction

> "The elimination of internal frontiers between Member States enables undertakings in the Community to expand their activities throughout the internal market and consumers to benefit from increased competition. These advantages must not be jeopardized by distortions of competition caused by aid granted unjustifiably to undertakings." [2]

> "Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the common market."[3]

These statements in the Notice on cooperation between national courts and the Commission in the State aid field and by the CJEU respectively, provide a helpful introductory summary of the strict state aid control regime of the the EU. The EU has without doubt the most sophisticated and recognised state aid control regime in the world, since state aid by a member state may "interfere with conditions of competition" and may affect trade between member states. The state aid rules have a long history as they are an expression of the original integration ideals of what is today the EU.[4]

This chapter will examine the EU's state aid control rules. Questions such as (i) what is state aid regulation, (ii) why does it exist within the EU, (iii) who is it applicable to, and (iv) when does it apply will be asked and discussed.

The EU state aid control model serves as the foundation for the recommendations which will be made for South Africa in chapter 5. Firstly, such an examination will help to determine whether the regulation of state aid could play a role to improve

[2] Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* No C 312/07 [1995].
[3] Case 290/ 83 *Commission v France* (1985) ECR 48.
[4] For a concise introduction to the European Union and European integration see J McCormick *Understanding the European Union: A Concise Introduction* 6 ed (2014).

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"financial and operational performance" of SOEs in South Africa. From a South African perspective such an inquiry is pivotal, especially in the light of the many failing SOEs which are part of the South African economy and which on so many occasions have required governmental assistance in order to stay afloat. Secondly, such an examination will also help to determine whether the EU model, which is a supranational model, could apply with modifications to a single state such as South Africa.

In preparation of the proposed recommendations for South Africa in chapter 5, this chapter will examine and discuss the evolution of the EU state aid control regime from when the first European treaty, which contained provisions of state aid control, was enacted, until the present. It will discuss the central role which European integration played in the evolution of the state aid control regime. It also discusses the five different elements of the EU state aid prohibition and the procedural rules relating to the EU state aid prohibition. The institutional structures which are responsible for enforcing the state aid control regime will also be discussed. Lastly, the application of the state aid rules to public undertakings and services of general economic interest in the EU, as well as those systems outside of the EU which ultimately achieve the same outcomes as the EU state aid rules, will be discussed.

2 Reasons for the limitation of state aid in the EU

Governments all over the world subsidize activities performed in their economies and such subsidization is nothing new. Jaeger states that Adam Smith in his famous work, Nature and Causes of the Wealth of Nations, already made mention of certain measures of subsidization.[5] It is further stated that state aid may be used as a measure by governments to steer their economies.[6] It is also part of sovereign policy for governments to decide to whom, when and in what form to allocate state aid.[7]

State aid to enterprises therefore forms an accepted part of economic policy of countries all over the world. It provides governments with opportunities to correct

[5] See T Jaeger "Distinguishing state and private subsidies: a closer look at the state character test" in J Drexl & V Bagnoli (eds) *State-initiated Restraints of Competition* (2015) 296 296.
[6] See T Jaeger "Distinguishing state and private subsidies: a closer look at the state character test" in J Drexl & V Bagnoli (eds) *State-initiated Restraints of Competition* (2015) 296 296.
[7] See T Jaeger "Distinguishing state and private subsidies: a closer look at the state character test" in J Drexl & V Bagnoli (eds) *State-initiated Restraints of Competition* (2015) 296 296.

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market failures and to achieve other objectives which could benefit the broader society.[8] As noted by Hancher, Ottervanger and Slot, the reasons for state aid varies from economic, social, political and strategic reasons.[9] So why does a supranational entity like the EU needs rules on state aid control?

The internal market (formerly known as the common market), which was first established by the ECSC Treaty[10] and then the EEC Treaty,[11] is the reason for the existence of the EU state aid rules. The common market was a fundamental element of the EEC Treaty. It was regarded as critical to the achievement of the aims set out in Article 2 of the EEC Treaty, which included a harmonious development of economic activities and higher standards of living for the peoples of the Community. The common market established by the EEC Treaty was replaced by an internal market after the Lisbon Treaty of 2007 came into effect.[12] The internal market comprises of an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the TFEU and the TEU.[13] It covers almost all economic activities: there are only a few limited exceptions.[14] Market conditions[15] in the EU are thus "similar to those in the market of a single state."[16] Hence, state aid control became an integral part of the EU competition policy,[17] which forms part of the national legal systems of member states. The CJEU in *Flamino Costa v ENEL* remarked:

> "By contrast with ordinary international treaties, the EEC Treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of

[8] See for example in this regard the discussion on the role of SOEs in the South African society in para3 2 of chapter two.
[9] L Hancher, T Ottervanger & PJ Slot *EC State Aids* (2012) para 2-004.
[10] Article 1 of the ECSC Treaty.
[11] Article 2 of the EEC Treaty.
[12] Article 1 of the Lisbon Treaty.
[13] Article 26 of the TFEU *Official Journal of the European Union* No C326/92 [2012].
[14] For the exceptions see J Fairhurst *Law of the European Union* 8 ed (2010) 7.
[15] These include the elimination of custom duties between member states, elimination of quantitative restrictions on the import and export of goods between member states, a common customs tariff and commercial policy towards third parties, removal of obstacles to the free movement of persons, services and capital, common agricultural policy, common transport policy, community competition policy. See J Fairhurst *Law of the European Union* 8 ed (2010) 7.
[16] J Fairhurst *Law of the European Union* 8 ed (2010) 7.
[17] See the discussion on EU statutory competition law in para 4.3.7 of chapter three.

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> the legal systems of the Member States and which their courts are bound to apply."[18]

The drafters of both the ECSC Treaty and EEC Treaty envisaged that intervention in the economy by a member state could have a devastating effect on competition and trade within the common market. When the state provides state aid to an undertaking which gives it an advantage over other undertakings, its intervention may cause distortions of competition within the internal market. This may be the case as its intervention may afford the benefiting enterprise benefits which it might have been unable to obtain through normal economic activity in the market. Hence state aid in any form runs counter to competition on the merit.[19] It alters incentives of market players, creates moral hazard, encourages excessive risk-taking by the management of undertakings and creates inefficiencies.[20] State aid rules ensure (i) that those undertakings which are most efficient receive the rewards to which a level playing field entitles them,[21] and (ii) ensure that dominance in a market is not created for certain undertakings.[22] A restrictive policy on state aid is thus essential for both the creation and maintenance of effective competition within EU markets. It aims to eliminate any economic advantage to an undertaking which it would not have obtained under normal market conditions. The establishment of a system which would ensure that competition within the common/internal market shall not be distorted and trade between member states shall not be affected due to state intervention was regarded as important to the attainment of the goals in the EEC Treaty (today the TFEU) quicker.[23]

Restrictions on subsidies may also promote efficiency even beyond the direct harm that it is does to market rivalry. It will "prevent *tit-for-tat* reactions of the type: "Since

[18] Case 6-64 *Flaminio Costa v ENEL (Ente Nazionale Energia Elettrica (National Electricity Board)* [1964] ECR 585 593.
[19] See T Jaeger "Distinguishing state and private subsidies: a closer look at the state character test" in J Drexl & V Bagnoli (eds) *State-initiated Restraints of Competition* (2015) 296 296.
[20] U Soltesz & C Von Kockkritz *"*The Temporary Framework- the Commission's Response to the crisis in the real economy*"* (2010) 31(3) *European Competition Law Review* 106 106.
[21] See the State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005).
[22] L Hancher, T Ottervanger & PJ Slot *EC State Aids* (2012) para 2-008.
[23] See Article 1 of the Treaty Establishing the European Economic Community.

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you give aid to your industry, I help my industry too""[24] and avoid a "wasteful subsidy race" and the "protection of national champions".[25]

This is closely related to the central aim of the European project which is market integration. While each of the member states has its own domestic economic policies, the internal market must not be undermined and needs to be protected by each EU member state. This requires common limitations on individual economic policies. While the EU does not intend to harmonize the economic policies of member states, it wants to ensure that the treaty goals of a well-functioning internal market is realised.[26] Therefore a member state cannot be allowed to protect firms within its borders from external competition. Member states do not have the luxury to adopt a "do not care much" attitude in regard to competition in external trade especially when trading with other member states, since they are required by treaty law to comply with EU competition policy. The state aid control rules thus "limit the possible negative repercussions of national state aids on European market integration."[27]

It is vital to refer to the EU Commission's explanation of the importance of having a supranational state aid control regime. In the State Aid Action Plan of 2005-2009 (the SAAP) the Commission states that:

> "State aid policy safeguards competition in the Single Market and it is closely linked to many objectives of common interest, like services of general economic interest, regional and social cohesion, employment, research and development, environmental protection and the protection and promotion of cultural diversity. It must contribute by itself and by reinforcing other policies to making Europe a more

[24] L Hancher, T Ottervanger & PJ Slot*EC State Aids* (2012) para 2-013.
[25] L Coppi "The Role of Economics in State Aid analysis and the balancing test" in E Szyszczak (ed) *Research Handbook on European State aid Law* (2011) 64 75.
[26] The EU consists currently of twenty eight member states, with Croatia as the last member state to join in 2013. Unlike the position within a single state, which can provide subsidies as it feels necessary for the smooth functioning of its economy, there are twenty seven other member states which economies may be impacted on if one provides state aid to its undertakings.
[27] I Ganoulis & R Martin "State Aid Control in the European Union: Rationale, Stylised Facts and Determining Factors" (2001) 36(6) *Intereconomics* 289 297.

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> attractive place to invest and work, building up knowledge and innovation for growth and creating more and better jobs." [28]

The Commission further states:

> "The objective of State aid control is, as laid down in the founding Treaties of the European Communities, to ensure that government interventions do not distort competition and trade inside the EU."[29]

The CJEU has also provided its explanation why state aid control within the EU is so important. In *Spain v the Commission*[30] the court stated that when financial aid is provided to an undertaking by a member state, such aid strengthens the position of the undertaking compared with the competitor of that undertaking within the intra-Community trade. This affects the position of the competitor, since it firstly, strengthens the beneficiary undertaking domestically in that it is not required to export its products. Secondly, the beneficiary undertaking may maintain or even increase its domestic production since it might be too difficult for another competitor to enter the market of the beneficiary undertaking, thus lessening the possibility of competitors exporting their products to that market. Economists' reasons for the control of state aid within the EU include economic efficiency, efficient allocation of resources, and optimization of allocated resources.[31] Coppi observes that economic analysis started to be part of European competition law from the late nineties, with the CJEU already recognising it in the 1960s.[32] However, economic analysis did not gain traction in state aid decisions, even though it had been applied for quite some in other areas of competition law. In the first instance the application of economics is

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[28] Para 15 of the State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005) (accessible at http://ec.europa.eu/competition/state_aid/reform/archive.html).

[29] See State Aid Control Overview (http://ec.europa.eu/competition/state_aid/overview/index_en.html) (accessed on 15 September 2015).

[30] Joined Cases C-278/92, C-279/92 and C-280/92 [1994] ECR I-04103 para 40.
Other cases in which the Court of Justice refers to the reasons for the EU state aid rules includes 173/73 *Italy v Commission* [1974] ECR 709 para 26 where the court stated that "The aim of Article 92 [now Article 107] is to prevent trade between Member States from being affected by benefits granted by the public authorities which, in various forms, distort or threaten to distort competition by favouring certain undertakings or the production of certain goods." See also Case C-39/94 *Syndicat Français de l' Express International (SFEI) and others v La Poste and Others* [1996] ECR I-3547 para 58.

[31] For a general overview see L Coppi "The role of economics in State aid analysis and the balancing test" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 64 64-89.

[32] L Coppi "The role of economics in State aid analysis and the balancing test" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 64 85.

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limited by Article 107 of the TFEU which provides a detailed description of illegal state aid.[33] Coppi further notes that the exceptions to the state aid rules which are expressly listed in Articles 107 (2) and (3) of the TFEU also are an obstacle to applying economic analysis to state aid.[34] The lack of economic analysis in the context of state aid was stressed by the then European Commissioner for Competition Policy, Neelie Kroes, who in 2007 stated that "even if we knew economic analysis was useful, we did not always make systematic use of it."[35]

However, the Commission's attitude towards economic analysis for state aid cases is changing. The SAAP constituted the first modernization of the state aid rules, since its inception. Described as a "roadmap to the future development of EC state aid policy", the SAAP provides that "a more refined economic approach" would be followed to evaluate state intervention in markets.[36] Economic analysis of state aid has thus been given more prominence by the SAAP. The Commission's commitment to make greater use of economic analysis in the context of state aid is also illustrated by its introduction of a "balancing test". The Commission states in the SAAP that "appreciating the compatibility of state aid is fundamentally about balancing the negative effects of aid on competition with its positive effects in terms of common interest."[37] Hancher, Ottervanger and Slot thus correctly noted that economic analysis of state aid within the EU has become "indispensable".[38]

Kleiner explains the reasons for the state aid rules by using three analysing models which have played a role in the development of the EU state aid regime. The first model is called the "derogatory model", which connects state aid closely to the European single market.[39] In terms of this analysis any state aid by a member state

[33] For more on the law and economics of state aid see L Coppi "The role of economics in State aid analysis and the balancing test" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 64 64-89.
[34] L Coppi "The role of economics in State aid analysis and the balancing test" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 64 64.
[35] N Kroes "The Law and Economics of State aid control- a Commission Perspective", presented at the Joint EStALI/ESMT Conference, "The Law and Economics of European State Aid Control" in Berlin, 8th October 2007 (available at http://europa.eu/rapid/press-release_SPEECH-07-601_en.htm?locale=en) (accessed on 9 November 2015).
[36] See the State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005).
[37] State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005).
[38] L Hancher, T Ottervanger & PJ Slot *EC State Aids* (2012) para 2-001.
[39] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 1-5.

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may make the removal of trade barriers obsolete.[40] Lower import prices are one result of the removal of trade barriers. State aid, however, eliminates this benefit.[41] In terms of Kleiner's "derogatory model" a state aid control regime thus ensures "the preservation of the single market".[42] Secondly, Kleiner uses the "competition model" to explain the negative effects which state aid may have on competition within the EU.[43] In this respect state aid regulation is a tool to ensure that markets are functioning efficiently by addressing market failures.[44] Kleiner is of the opinion that unlike his "derogatory model, which perceives state aid outright as wrong for the single market, the "competition model" allows the possibility of "good State aid".[45] Thirdly, Kleiner lists the "political integration model" which considers the state aid control regime as a means for "controlling governments and coordinating their economic policies".[46] This model thus envisages greater integration.[47] Kleiner's different models are well aligned with the reasons for the existence of EU state aid control provided above by other scholars, the Commission and the Court of Justice. Although most justifications for the existence of the state aid control regime refer to the internal market as the overarching reason, extensive reference is also made to those other aspect alluded to by Kleiner.[48] In particular Kleiner's "good State aid" argument can be justified on the basis of Article 107 of the TFEU together with Commission Regulations[49] which allow certain exemptions[50] to the state aid prohibition[51] and therefore already recognises that there is "good State aid".

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[40] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 2.
[41] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 2.
[42] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 2.
[43] T Kleiner "Modernization of State Aid Policy" in E Szyszcak *Research Handbook on European State Aid Law* (2011) 1 3.
[44] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 4.
[45] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 3.
[46] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 4.
[47] T Kleiner "Modernization of State Aid Policy" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 1 4.
[48] See for example the Commission's explanation above in this paragraph where it refers to the close link between the state aid policy and many objectives of common interest. See also L Hancher, T Ottervanger & PJ Slot *EC State Aids* (2012) para 2-004 as mentioned above in this paragraph, who noted the social, political and strategic reasons for state aid control regime beside the economic reasons.
[49] See the discussion on exemptions in para 5 of this chapter.

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Undertakings in all member states should thus compete as if they are operating in one State. State aid by member states to any public or private undertaking, operating within its jurisdiction may severely affect competition between undertakings and trade between member states. It will place the benefitting undertaking in a better position than its competitors operating either in the same or in another member state. Consequently any activities which may give an unjustified benefit to an undertaking need to be regulated.

3 A historical overview of how the EU state aid rules developed and evolved

3 1 European Integration

The state aid control regime is a direct result of the European integration process which started after World War II. This consequently justifies a comprehensive overview of the European integration process in order to understand and appreciate the reasons for the existence of the EU state aid control regime.

The idea of a united Europe had been around long before the two world wars but only became a serious possibility after Europe was morally and economically destroyed by the two world wars.[52] It is a "historical process" in terms of which nation states in Europe decided to transfer certain of their sovereign powers to a supranational institution.[53] David Cameron, a former British Prime Minister, described the EU as "a group of countries that used to fight each other and kill each other, and have actually now come together in a common endeavour".[54] This description provides a true picture of where the EU has started and where it is today; from animosity between European states to peace and prosperity as part of a supranational institution.

As stated in chapter three, the first integration efforts started with the establishment of the ECSC in 1951[55] by Belgium, France, Italy, Luxembourg, the Netherlands and

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[50] See the discussion on exemptions in para 5 of this chapter.
[51] See the discussion of the elements of the state aid prohibition in para 4 of this chapter.
[52] M Gilbert *European Integration: A Concise History* (2012) 4.
[53] M Gilbert *European Integration: A Concise History* (2012) 1.
[54] David Cameron gave this description of the EU while delivering a speech on a possible British exit from the EU at the 2016 World Economic Forum in Davos.
See http://failover-www.thesundaytimes.co.uk/newsreview/features/article1669833.html (accessed on 24 February 2016).
[55] The Treaty, however, only entered into force on 23 July 1952.

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West Germany[56] through the Treaty establishing the European Coal and Steel Community (the ECSC Treaty). This treaty was a direct result of the Schumann Plan, named after Robert Schuman, the French foreign minister at the time.[57] Schuman proposed that European nations placed their coal and steel industries under the auspices of a supranational institution. Schuman's proposal resulted from his opinion that ""Europe will not be made all at once or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity."[58] He believed that by placing the steel and coal industries of Germany and France under the supervision of an independent body, it would help to diminish or eliminate the competition between the two nations since animosity between France and Germany was central to armed conflict in Europe.[59] The ECSC Treaty thus provided the "basis for a broader and deeper community amongst peoples long divided by bloody conflict."[60]

Schuman's proposal was at first seen as "wishful thinking" but it materialised and the ECSC was created as the "first modern experiment in partial supra-national government". The ECSC Treaty achieved what was not expected to happen so soon after the end of a bloody World War Two, namely closer working relations between former enemies. Whatever animosity there was during the war was set aside in the interest of a more integrated Europe. Any doubts as to whether a treaty would managed to thaw the once icy relations between its member states, soon started to disappear.[61] Friedmann states that within two years of the coming into effect of the ECSC Treaty, "an atmosphere of harmony and co-operation" could be sensed at the headquarters of the ECSC.[62]

The ECSC Treaty ignited the flame of European integration. The ECSC was a major reason for the rapid improvement of relations between France and Germany after

[56] See I Bache, S Bulmer, S George & O Parker *Politics in the European Union* (2015) 95-97 for an interesting read on the reasons why these particular countries decided to become part of the first European integration effort.
[57] For further reading see R Vernon "The Schuman Plan: Sovereign Powers of the European Coal and Steel Community" (1953) 47(2) *American Journal of International Law* 183 183-202.
[58] See D Gowland & A Turner *Britain and European Integration 1945-1998: A Documentary History* (2001) 23.
[59] See J Gillingham *Coal, Steel, and the Rebirth of Europe, 1945-1955: The Germans and French: From Ruhr Conflict to Economic Community* (1991) ix.
[60] See the Preamble of the ECSC Treaty.
[61] See W Friedmann "The European Coal and Steel Community" (1955) 10(1) *International Journal* 12 12.
[62] See W Friedmann "The European Coal and Steel Community" (1955) 10(1) *International Journal* 12 12.

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the war. It remains a matter of conjecture as to when and if Europe might have seen better relations between its nations after the war if it were not for the ECSC Treaty.

Soon after the creation of the ECSC, talk of greater integration in other economic and political spheres started.[63] Plans for integration in the fields of agriculture, transportation, currency and banking were discussed.[64] The European Defence Community, another one of France's initiatives to keep Germany under control by creating closer ties, was created in 1952 as a next step to greater integration. It arose as a result of a declaration on the rearmament of Germany by the then Prime Minister of France, Rene Pleven, which later became known as the "Pleven Plan".[65] France suggested the European Defence Community as a counter measure to "rapid normalization" of the German armed forces. This community, however, failed to become the same success story as the ECSC. At that point nation states were more willing to forego sovereignty in regard to economic matters but they were more reluctant to give up control over matters such as defence and foreign affairs.[66]

The six founding nations of the ECSC Treaty were willing to broaden cooperation. Proposals were made for greater economic cooperation, cooperation in regard to transport, the use of nuclear energy, a European market with no trade barriers and the harmonization of social policies.[67] Paul-Henri Spaak, one of the founding fathers of European integration, chaired an inter-governmental committee which was tasked with looking into the proposals.[68] The committee's work resulted in what became known as the Spaak Report, which was accepted by the six states that would become the founding member states of the European Economic Community.[69] As a result more European integration followed in 1957 with the signature of two treaties in Rome. The first became known as the treaty on the European Economic Community (the EEC Treaty), which is also known extensively in the literature and English speaking countries such as Great Britain[70] as the common market treaty. It

[63] HL Krekeler "European Integration" (1953) 47 *American Society of International Law Proceedings* 166 167.
[64] HL Krekeler "European Integration" (1953) 47 *American Society of International Law Proceedings* 166 167.
[65] J Goormaghtigh "France and the European Defence Community" (1954) 9 *International Journal* 96-97.
[66] M Gilbert *European Integration: A Concise History* (2012) 34.
[67] M Gilbert *European Integration: A Concise History* (2012) 46. See also UP Toepke "The European Economic Community: A Profile" (1981) 3(2) *Northwestern Journal of International Law & Business* 640 642.
[68] M Gilbert *European Integration: A Concise History* (2012) 46-47.
[69] M Gilbert *European Integration: A Concise History* (2012) 46.
[70] See M Gilbert *European Integration: A Concise History* (2012) 95.

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established the EEC. The second treaty, which became known as the Euratom Treaty, established Euratom. Euratom, the lesser known of the two communities created at the same time, was tasked (i) to contribute to the raising of the standard of living in the member states and (ii) to the development of relations with the other (non-member state) countries by creating the conditions necessary for the speedy establishment and growth of nuclear industries.[71] This task would be achieved, inter alia, with the promotion of research in nuclear energy, the dissemination of technical information in regard to nuclear energy, establishment of uniform safety standards for workers of the nuclear energy industry, the equal distribution of nuclear fuels and by ensuring that nuclear materials would be used for peaceful purposes.[72]

The EEC on the other hand focused on general economic cooperation between the member states. The EEC had "a far broader scope" than the ECSC, which only focused on the coal and steel industries of the member states. It has been described as "an organism of supranational character in constant evolution towards greater unity in virtually all aspects of life"[73] and as "a new legal order of international law".[74] The preamble of the EEC Treaty stated that the six founding nations were determined to establish the foundations of an ever closer union amongst the European people. Although the ECSC Treaty established a common market for the steel and coal industries only, the EEC Treaty went further by establishing a common market for all sectors of the EEC economy. By the 1960s there were thus three European communities in existence; each with its own scope of application and institutional framework. The Treaty establishing a Single Council and a Single Commission of the European Communities, also referred to as the Merger Treaty, brought significant changes in 1965 with regard to further and greater integration. The six nation states which participated in the ECSC, Euratom and the EEC wanted further progress towards European integration. They recognised the importance of a unified institutional framework for the three existing European communities. Consequently it was decided to establish a single Council and a single Commission

[71] See Article 1 of the Treaty Establishing the European Atomic Energy Community.
[72] See Article 1 of the Treaty establishing the European Atomic Energy Community.
[73] UP Toepke "The European Economic Community: A Profile" (1981) 3(2) *Northwestern Journal of International Law & Business* 640 640.
[74] Case 26/62 *Van Gend & Loos v Netherlands Inland Revenue Administration* [1963] ECR- 1 12.

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of the European Communities.[75] The single Council replaced the Special Council of Ministers of the ECSC, the Council of the EEC and the Council of the Euratom.[76] The single Council retained the powers and competences which these separate institutions had in terms of the treaties which established them. The treaty also created a Commission of the European Communities (the Commission). This Commission replaced the High Authority of the ECSC, the Commission of the EEC and the Commission of Euratom.[77] The Commission retained all the powers and competence conferred on these three individual administrative bodies by the treaties which established them.

The TEU, commonly referred to as the Maastricht Treaty, was signed in 1992 by the twelve member states at the time.[78] It amended the Treaty establishing the EEC in order to establish a single European Community.[79] It substantially amended the EEC Treaty and replaced all reference to the EEC with the term European Community (EC).[80] The change from the EEC to the EC was a timely indication that future integration was not meant to be merely of an economic nature but that it would be extended to include other policy areas. The Maastricht Treaty created the EU as it is known today and it is founded on the three pillars of the European Communities, namely the EEC, the ECSC and Euratom.[81] The Lisbon Treaty, which came into force on 1 December 2009, bestowed legal personality on the EU[82] and the EC Treaty became known as the TFEU.[83] The Treaty of Lisbon also determines that the EC is replaced and succeeded by the EU.[84] It is within this context that the state aid rules as it is known today started to be applied; first within the ECSC and the EEC, then the EC and the present-day EU. Hence it is important that an overview of the state aid control rules as it was in the founding Communities of the EU is provided.

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[75] See the Preamble of the Treaty establishing a Single Council and a Single Commission of the European Communities.
[76] See Article 1 of the Treaty establishing a Single Council and a Single Commission of the European Communities.
[77] See Article 9 of the Treaty Establishing a Single Council and a Single Commission of the European Communities.
[78] Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal and the United Kingdom.
[79] See Title II of the TEU.
[80] See Article G of the TEU.
[81] See Article A of the TEU.
[82] Article 46 A of the Lisbon Treaty.
[83] J Fairhurst *Law of the European Union* 8 ed (2010) 14.
[84] See Article 1 of the Lisbon Treaty.

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3 2 The state aid prohibition in the ECSC Treaty

The member states concluded the ECSC Treaty for a period of fifty years.[85] Articles 2 and 3 of the ECSC Treaty set out the tasks of the ECSC and its institutions. Such tasks, included contributing to economic expansion, growth of employment and a rising standard of living in the member states, to ensure an orderly supply of coal and steel to the common market, to ensure that all comparably placed customers in the common market have equal access to the sources of production, observation of prices and the conditions under which they are set, and to ensure conditions which would encourage the production potential of undertakings.

The regulation of state aid in the EU was started by Article 4 (c) of the ECSC Treaty. Article 4 (c) of the ECSC Treaty stated that subsidies or aids granted by States, or special charges imposed by States, in any form whatsoever are incompatible with the common market for coal and steel and thus prohibited within the Community. There was no definition of state aid in the ECSC Treaty. The CJEU provided its definition of the concept as found in the ECSC Treaty in the "first State aid case" of De *Gezamenlijke Steenkolenmijnen v The High Authority*[86] when it said that:

> "The concept of aid is wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking."

The court however qualified its definition by saying the definition is only acceptable if it actually is "borne out" by the provisions of the Treaty or its objectives. The court further stated that the words "in any form whatsoever" created an unusually wide meaning of the prohibition of state aid especially since these words were not part of the other subsections of Article 4 of the ECSC Treaty.[87] The provision thus placed an "absolute ban" on any state aid to the undertakings in the coal and steel industry.[88]

[85] The treaty expired on 23 July 2002.
[86] Case 30/59 ECLI: EU: C: 1961: 2 para 19.
[87] Case 30/59 ECLI: EU: C: 1961: 2 para 21.
[88] T Hancher, T Ottevanger & P Slot *EC State Aids* (2012) para 14-002.

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The ECSC Treaty did also not contain a de minimis rule.[89] All state aid was banned by Article 4 (c) of the ECSC Treaty.[90] In this regard, the CJEU in *Neue Maxhutte Stahlwerke and Lech-Stahlwerke v the Commission* stated that the wording of Article 4 (c) of the ECSC Treaty did not provide that any aid with a slight impact on competition is removed from the scope of the prohibition. Hence the Commission had no duty to determine whether the aid distorts or threaten to distort competition.[91] The court further stated that Article 4 (c) prohibits all aid, without restrictions and there are no exceptions. Consequently Article 4 (c) did not "embody" a de minimis rule.[92]

Article 95 of the ECSC Treaty was the only limitation on the wide prohibition under Article 4 (c).[93] It provided that:

> "In all cases not provided for in this Treaty where it becomes apparent that a decision or recommendation of the Commission is necessary to attain, within the common market in coal and steel and in accordance with Article 5, one of the objectives of the Community set out in Articles 2, 3 and 4, the decision may be taken or the recommendation made with the unanimous assent of the Council and after the Consultative Committee has been consulted. Any decision so taken or recommendation so made shall determine what penalties, if any, may be imposed."

The article allowed the High Authority to make decisions or recommendations in order to achieve the objectives of the ECSC Treaty. Such decisions or recommendations could be made with the unanimous consent of the Council and after consultation with the Consultative Committee. The High Authority started to use Article 95 from the beginning of the 1980s when the coal and steel industry had to be reconstructed to establish a "Community scheme" to allow state aid in certain

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[89] Para 4 5of this chapter provides a detailed discussion of the de minimis rule. It suffices to state at this point that state aid without an "appreciable effect" on trade and competition between member states and below a certain amount is not considered to be state aid within the meaning and scope of Article 107 of the TFEU.
[90] Only after the Commission implemented its "Aid Codes" in the 1980s certain state aid could be exempted from the absolute ban.
[91] Cases T-129/95, T-2/96 and T-97/9 *Neue Maxhutte Stahlwerke and Lech-Stahlwerke v the Commission of the European Communities* [1999] ECR II-17 para 147.
[92] Cases T-129/95, T-2/96 and T-97/9 *Neue Maxhutte Stahlwerke and Lech-Stahlwerke v the Commission of the European Communities* [1999] ECR II-17 para 147.
[93] *Neue Maxhutte Stahlwerke and Lech-Stahlwerke v the Commission of the European Communities* [1999] ECR II-17 para148.

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circumstances.[94] Some "major modernization, rationalization and restructuring efforts" required an updated approach to the blanket ban in the ECSC Treaty.[95] Hence the Commission adopted various "Aid Codes"[96] justified by Article 95, in order to allow aid within the coal and steel industries.[97] The "Aid Codes" relaxed or lifted the wide ban placed on the allocation of state aid to the coal and steel industries. By relaxing the blanket ban on state aid to these two industries it became possible for aid to be allocated to undertakings under certain circumstances.[98]

In regard to any procedure relating to the state aid prohibition in the ECSC Treaty, it is important to note that the ECSC Treaty contained no procedural rules on the application of the state aid prohibition. A procedure for notification to the High Authority of any planned aid was not necessary because of the general ban on state aid. The absence of any procedure could also be justified by the limited scope of the ECSC Treaty (it applied to only two sectors of the Community economy). However, as mentioned above, when the two sectors required modernisation to keep up with development and when the Commission enacted the Aid Codes, the Commission also implemented a number of procedural rules.[99]

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[94] *EISA v the Commission* Case T-239/94 [1997] ECR II-01839 para 3.
See also Joined Cases C-74/00 P and C-75/00 *Falck and Acciaierie di Bolzano v the Commission* [2002] ECR I-7869 para 3.

[95] See Section I Commission Decision No 3632/93/ECSC of 28 December 1993 establishing Community rules for State aid to the coal industry *Official Journal of the European Communities* No L 329/12 [1996].

[96] These include Commission Decision No 257/80/ECSC of 1 February 1980 establishing Community rules for specific aids to the steel industry which was the First Steel Aid Code which expired 31 in December 1981. Commission Decision No 2320/81/ECSC of 7 August 1981 establishing Community rules for aids to the steel industry, as amended was Second Aid Code and it expired on 31 December 1985. Commission Decision No 3484/85/ECSC of 27 November 1985 establishing Community rules for aid to the steel industry was the Third Aid Code and expired on 3 December 1988. Commission Decision No. 322/89/ECSC of 1 February 1989 establishing Community rules for aid to the steel industry was the Fourth Aid Code and expired on 31 December 1991. Commission Decision No 3855/91/ECSC of 27 November 1991 establishing Community rules for aid to the steel industry was the Fifth Aid Code and it expired on 31 December 1996. Commission Decision No 2496/96/ECSC of 18 December 1996 establishing Community rules for State aid to the steel industry was the Sixth Aid Code. See also Joined Cases C-74/00 P and C-75/00*Falck and Acciaierie di Bolzano v Commission* [2002] ECR I-7869 paras 3-6.

[97] *EISA v the Commission* Case T-239/94 [1997] ECR II-01839 para 66.

[98] See Commission Decision No 3632/93/ECSC of 28 December 1993 for when state aid was allowed to the coal industry and Commission Decision No 2496/96/ECSC of 18 December 1996 for when state aid was allowed for the steel industry.

[99] For the procedural rules which were implemented in the coal industry see Section III of the Commission Decision No 3632/93/ECSC of 28 December 1993 establishing Community rules for State aid to the coal industry *Official Journal of the European Communities* No L 329/12 [1996] which deals with notification, appraisal and authorization procedures for state aid measures in the coal industry. For those rules which were implemented for the steel industry see Article 6 of the Commission Decision No 2496/96/ECSC of 18 December 1996 establishing Community rules for State aid to the steel industry *Official Journal of the*

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The ECSC Treaty and the last two active "Aid Codes" expired in July 2002. Hereafter, the coal and steel industries were integrated with the general "economic framework" of the EU. Consequently the state aid control regime which was effective in the EU at the time when the ECSC Treaty expired became also applicable to the steel and coal industries. Hence, the same procedural rules now apply for state aid to the coal and steel industries.

3 3 The state aid prohibition in the EEC Treaty

After World War II many industries were nationalised in Europe.[100] This meant that the initial six member states of the EEC had control over a number of industries of their economies. Accordingly, high-levels of state intervention existed within all these state-controlled industries. Article 92 of the EEC Treaty addressed this position. Article 92 contained a similar prohibition than Article 4 (c) of the ECSC Treaty, but this time not only in regard to particular sectors of the Community's economy. It applied to every economic sector within the EEC.

Like the ECSC Treaty, the EEC Treaty provided no specific definition of state aid. One reason given for the absence of a concise definition is that any concrete definition would have left gaps that would have allowed states to easily circumvent the provision.[101] Instead, Article 92 of the EEC Treaty introduced certain requirements which an activity or transaction had to meet in order for it to be aid that falls within the ambit of the prohibition. Article 92 provided as follows:

"1. Except where otherwise provided for in this Treaty, any aid, granted by a Member State or granted by means of State resources, in any manner whatsoever, which distorts or threatens to distort competition by favouring certain enterprises or certain productions shall, to the extent to which it adversely affects trade between Member States, be deemed to be incompatible with the Common Market.

2. The following shall be deemed to be compatible with the Common Market:

European Communities No L 338/42 [1996], which set out the procedure which member states had to follow when they wanted to grant aid to industries in the steel industry.

[100] See para 2 of chapter 2 for a comprehensive discussion on nationalisation in the three selected EU member states after World War II.

[101] M Schutte "The Notion of State Aid" in M S Rydelski (ed) *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade* (2006) 23 23.

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(*a*) aids of a social character granted to individual consumers, provided that such aids are granted without any discrimination based on the origin of the products concerned;

(*b*) aids intended to remedy damage caused by natural calamities or other extraordinary events; or

(*c*) aids granted to the economy of certain regions of the Federal Republic of Germany affected by the division of Germany, to the extent that such aids are necessary in order to compensate for the economic disadvantages caused by such division.

3. The following may be deemed to be compatible with the Common Market:

(*a*) aids intended to promote the economic development of regions where the standard of living is abnormally low or where there exists serious under-employment;

(*b*) aids intended to promote the execution of important projects of common European interest or to remedy a serious disturbance of the economy of a Member State;

(*c*) aids intended to facilitate the development of certain activities or of certain economic regions, provided that such aids do not change trading conditions to such a degree as would be contrary to the common interest. Any aids to shipbuilding existing on 1 January 1957 shall, to the extent that such aids merely offset the absence of customs protection, be progressively reduced under the same conditions as apply to the abolition of customs duties, subject to the provisions of this Treaty relating to the common commercial policy in regard to third countries; and

(*d*) such other categories of aids as may be specified by decision of the Council acting by means of a qualified majority vote on a proposal of the Commission."

All advantages which were granted either directly or indirectly through state resources, whether it is the state itself granting the advantages or a private or public body established by the state, were considered to fall within the scope of Article

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92(1) of the EEC Treaty.[102] In order to qualify as state aid, the advantage needed to be made from state resources which constituted an additional financial burden for the state or by any public or private bodies established by the state.[103] All financial means which a public authority may use to support an undertaking was covered by the scope of Article 92(1) of the EEC Treaty.[104]

Article 92 (2) listed all those measures which were considered per se compatible aid, also sometimes referred to as the "automatic exceptions".[105] Article 92 (3) listed those measures which could have been considered compatible aid, also sometimes referred to as the "discretionary exceptions".[106] In regard to those state aid measures listed in Article 92 (2), the Commission had no discretion about its compatibility with the common market but only had to ensure that conditions were met in order for the aid measure to qualify under this provision. The Commission only had discretion to decide whether aid measures which fell within the scope of Article 92(3) were consistent with the state aid rules.[107] Since Article 92 (3)(d) provided the Council with the authority, after proposals by the Commission, to add other categories of aid to those listed in Article (2) and (3), those exemptions listed in the two sub-articles were thus not an exhaustive list of state aid measures which could be deemed to be compatible with the common market. Today these "automatic exceptions" and "discretionary exceptions" remain firmly in place in the TFEU, with very little change.[108]

Unlike the position in the ECSC Treaty in regard to procedural rules, such rules, formed part of the EEC Treaty right from the beginning and did not have to be implemented via Aid Codes. Procedural rules were required right from the start

[102] Case C-379/98 *PreussenElektra v AG v Schhleswag AG* [2001] ECR I-2099 para 58.
See also Case 82/77 *Openbaar Ministerie of the Netherlands v VanTiggele* ([1978] ECR 25 paras 23-25.
[103] Joined Cases C-72/91 and C-73/91 *Sloman Neptun Schiffahrts AG v Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG* (1993) ECR I-887 para19.
[104] Case C-482/99 *French Republic v Commission of the European Communities* [2002] ECR I-4397 para 37.
[105] L Hancher & F Salerno "State aid in the energy sector" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 246 256.
[106] L Hancher & F Salerno "State aid in the energy sector" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 246 256.
[107] L Hancher & F Salerno "State aid in the energy sector" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 246 256.
[108] See Article 107 (2) and 107 (3) of the TFEU. One addition that was made to the original provision in the EEC Treaty is Article 107 (3) (d) of the TFEU which provides for "aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest" to also be considered as an exemption to the state aid prohibition.

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particularly since this treaty provided a list of exemptions from the basic prohibition of state aid. The procedural rules were set out in Article 93 of the EEC Treaty. In terms of Article 93 member states were required to notify the Commission when they intended to grant aid to an undertaking or alter existing aid, in order for the Commission to determine the compatibility of the aid with the common market. The most important aspect of the procedural requirements was the notification of state aid by member states. The Commission was required to inform the member state that it had received the notification. Section 3 of Article 93 provided that:

> "The Commission shall be informed, in due time to enable it to submit its comments, of any plans to institute or to modify aids."

The CJEU provided clear guidance on the procedure in *Lorenz vs Germany.*[109] It stated that in terms of paragraph 1 of Article 93, where existing aid was concerned, the Commission was entitled to request a member state to abolish or amend the aid within a time frame provided by the Commission, while paragraph 3 sets out "prior control" for any new aid. The court also stated that by awarding the Commission sufficient time to submit its comments regarding any new aid or alteration to existing aid, the drafters of the EEC Treaty wanted to ensure that the Commission could properly consider, investigate and "form a prima facie opinion" on the compatibility of the aid with the treaty.[110]

Member states were thus not allowed to implement the state aid measures until the Commission had made a final decision as to its compatibility with the common market, thus complying with the so-called "standstill clause".[111] In the event that the Commission had decided that the planned aid was not compatible with the common market, it requested the member state to either abolish the plan to grant aid or to alter the existing aid within a specified time period. The Commission and any other member state with an interest, could refer the matter to the CJEU in the event that the member state which was planning to give aid or alter aid, did not comply with the Commission's request.[112]

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[109] Case 120/73 [1973] ECR -01471 1480.
[110] *Lorenz v Germany* Case 120/73 [1973] ECR -01471 1481.
[111] Article 93(3) of the EEC Treaty.
[112] Article 108 (2) of the TFEU.

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In conclusion, it is submitted that unlike the founders of the ECSC who had no precedent to refer to when they drafted the first state aid rules, the founders of the EEC had the opportunity to learn from the application of the state aid rules within the coal and steel industries. It is thus not surprising that the drafters of the treaty considered all those valuable lessons learned through the application of the state aid rules in the coal and steel industries, when the state aid rules under the EEC Treaty were formulated. The lessons learned are clearly reflected in the main difference between the state aid control regime under the ECSC Treaty and the EEC Treaty. In terms of Article 4 (c) of the ECSC Treaty, aid did not have to distort or threaten to distort competition in order for it to be considered incompatible with the common market.[113] This was because a general ban on state aid in any event existed until the 1980s when the Commission started to use the abovementioned "Aid Codes" to circumvent the general ban. In terms of the EEC Treaty, however, only those aid measures which distort or threaten to distort competition and adversely affect trade between member states were deemed to be incompatible with the common market. The CJEU thus made an important statement when it noted in *Steinike & Weinlig v Federal Republic of Germany* that the prohibition in Article 92 (1) is "neither absolute nor unconditional" since both the Commission and the Council have wide powers to "admit aids in derogation from the general prohibition in Article 92 (1)".[114] The ECSC Treaty was therefore not only the first treaty to start the integration process but it also allowed the Europeans to gain valuable experience with state aid rules that came in handy when EEC state aid rules were developed.

3 4 The treaty currently in force: the state aid prohibition in the TFEU

Beside certain Commission regulation on procedure and Council exemptions to the application of the state aid rules, few amendments have been made to the original EEC Treaty provisions on state aid.[115] A number of reasons may be submitted for

[113] C-111/99 P - *Lech Stahlwerke v Commission* [2001] para 41. See also JJP Lopez *The Concept of State Aid under EU Law: From internal market to the competition and beyond* (2015) 34.
[114] *Steinike & Weinlig v Federal Republic of Germany* [1977] ECR-595 para 8
[115] Only two changes were made to the original wording of the EEC Treaty. One additional circumstance was introduced when state aid may be deemed to be compatible with the common market. The other amendment refers to the Council's ability to make regulations after recommendation by the Commission for the application of the articles which deal with state aid and also the categories of state aid exempted from the procedural rules of the state aid regime. See par18 of the Maastricht Treaty. Although many other treaties followed, which include the treaties of Amsterdam, Nice and Lisbon, no substantial changes were made to the state aid rules. One change was made by the Amsterdam Treaty. This was in regard to the exemption dealing with aid to the

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this. Firstly, it may be an indication that the state aid rules established in 1957 had been very effective in controlling state aid by member states and that member states were happy with the state aid rules as they were initially implemented. Therefore there was no need over the years for drastic changes to something that had worked. Secondly, it might be that enforcement of the regime was not vigorous enough. Therefore any deficiencies which would have been exposed by vigorous enforcement were not picked up. However, the many successful challenges of state aid by the Commission, as shown by the EU jurisprudence, seem to favour the first explanation. In the light of this it is important to analyse the elements of the state aid prohibition as found in the TFEU.

4 The elements of the EU state aid prohibition

4 1 Introduction

While the notion of state aid has been the subject of various scholarly writings,[116] the five elements listed in Article 107 (1) of TFEU remain the most important point of departure for any analysis of what state aid entails.[117] A concept found nowhere else in the world, the state aid control regime of the EU, sets a regulatory framework that determines when and how member states may intervene in their economies. While the antitrust component of the EU competition policy is generally aimed at the behaviour of undertakings, those that are privately owned and government owned, state aid control is aimed at the behaviour of member states.[118] In order for any member state's intervention to qualify as state aid, certain elements set out in the TFEU must be present. In accordance with Article 107(1) of the TFEU the most

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shipbuilding industry. The articles on state aid control, as it were found in the ECC Treaty, were also renumbered. Articles 92 to 94 of the EEC Treaty became Articles 87 to 89 of the EC.

[116] See M Heidenhain *European State Aid Law* (2010) 23, who describe state aid as "State measures which grant one or more undertakings financial or other positive economic advantage (granting of positive benefits) involve State aid….. if the recipient undertaking receives an economic advantage which it would not have obtained under normal market conditions. Accordingly, aid is present to the extent the State provides an undertaking with benefits in cash, in kind or in services without receiving fair market value in return." C Quigley *European State Aid Law and Policy* 2 ed (2009) 3 states that state aid is "entailing an intervention by the State or through State resources encompassing a financial burden borne by the State that results in an advantage for an undertaking by mitigating the charges which are normally included in its budget….. State aid may arise in the context of commercial transactions involving a public authority, in so far as the counterparty is dealt with on terms which are more favourable than the market would normally offer." P Kent *European Union law* (2009) 354 states that "The giving of State aids or subsidies to a particular undertaking or industry distorts competition and undermines the free movement of goods."

[117] See also C-280/00 *Altmark Trans GmbH v Nahverkehrsgesellschaft Altmark GmbH* ECR I- 17747 para 75 for a discussion of these elements.

[118] C-D Ehlermann "State Aid Control in the European Union: Success or Failure" (1995) 18(4) *Fordham International Law Journal* 1212 1218.

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important characteristics which a state aid measure needs to show before it falls within the ambit of the prohibition are (i) it must be granted by a member state, (ii) or through state resources (iii) it must actually distort or threaten to distort competition, (iv) it must favour enterprises or productions and (v) it must adversely affect trade between member states.[119] All these elements must be simultaneously present in order for a state aid measure to qualify as such. These elements will now be discussed.

4 2 State aid granted by a member state or through state resources

The Commission states:

> "A company which receives *government support* obtains an advantage over its competitors. Therefore, the EC Treaty generally prohibits State aid unless it is justified by reasons of general economic development. To ensure that this prohibition is respected and exemptions are applied equally across the European Union, the European Commission is in charge of watching over the compliance of State aid with EU rules."[120]

Hence, this element of the prohibition targets all types of state benefit which an undertaking may receive from a member state whether through subsidies or tax benefits. The various ways in which governments may provide financial assistance to undertakings include (i) grants, (ii) capital injections, (iii) loans, (iv) guarantees and (v) provision or purchase of goods of services.[121] The Court of Justice stated that "Article 92(1) [now Article 107(1)] of the Treaty covers all the financial means by which the public sector may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector."[122]

The distinction made between aid granted by a state and aid through state resources is intended to ensure that both aid granted directly by the states and aid granted by a

[119] These five elements of state aid have been the subject of many EU court cases. See for example Case C-345/02 *Pearle BV, Hans Prijs Optiek Franchise BV and Rinck Opticiëns BV v Hoofdbedrijfschap Ambachten* [2004] ECRI-7139 para 33 and Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark* GmbH [2003] ECR I-0774 para 74-75.

[120] My emphasis.What is State aid (http://ec.europa.eu/competition/state_aid/overview/what_is_state_aid.html (visited on 31 October 2010).

[121] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009) 92.

[122] See *French Republic v Ladbroke Racing Ltd and Commission of the European Communities* [2000] ECRI-3271 para 50.

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public or private body designated or established by the State, is covered by the scope of the prohibition.[123] Advantages can only be categorised as aid within the meaning of the state aid prohibition if they are granted directly or indirectly through State resources and be imputable to the State.[124] If the state, for example, uses an intermediary such as a public or private body to provide aid, such measures would be covered by the prohibition.[125] In this regard the "principle of imputability" is applicable.[126] In accordance with this principle the actions of a public or private body may be attributed to the member state, even though a number of "indicators arising from the circumstances of the case and the context" have to be considered before state aid measure can be imputed to the member state.[127] These indicators may include but are not limited to:

(i) a public undertaking's integration into the structures of a public administration;

(ii) the nature of a public undertaking's activities and the exercise of the latter on the market in normal conditions of competition with private operators;

(iii) the legal status of the undertaking (in the sense of its being subject to public law or ordinary company law);

(iv) the intensity of the supervision exercised by public authorities over the management of a public undertaking;

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[123] See Case C-379/98 *Preussen Elektra AG v Schleswag AG* [2001] ECR I-2099 para 58.
In this regard see also the discussions in Case 82/77 *Openbaar Ministerie of the Netherlands v Van Tiggele* ([1978] ECR 25 paras 23-25; Joined Cases C-72/91 and C-73/91 *Sloman Neptun* [1993] ECR I-00887 para 19; Case C-189/91 *Kirsammer-Hack v Sidal* [1993] ECR I-6185 para 16; and Case C-126/91 GEMO [2003] ECR I-13769 para 23. Of importance are also the Court of Justice's comments on the imputability of state aid measures to the states. In this regard the court made it clear in Case-482/99 *French Republic v the Commission* [2002] ECR I-4397 para 52 that even if a public undertaking is controlled by a member state, not all aid measures taken by that undertaking can be imputed to the state especially if the undertaking has a certain level of autonomy from the state. The court stated that to determine whether state aid measure can be imputed to the state a number of "indicators arising from the circumstances of the case and the context" have to be considered.
[124] C-345/02 *Pearle BV, Hans Prijs Optiek Franchise BV and Rinck Opticiëns BV v Hoofdbedrijfschap Ambachten* [2004] ECR I-07139 para 35.
[125] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009) 152
[126] For more on this principle see the Stardust case: Case C-482/99 *French Republic v Commission of the European Communities* [2002] ECR I-04397 and also T Lubbig & M Von Merveldt "Stardust Marine: Introducing imputability into state aid rules- plain sailing into calm seas or rowing back into shallow waters?" 2003 24(12) *European Competition Law Review* 629 629-633.
[127] Case C-379/98 *Preussen Elektra AG v Schleswag AG* [2001] ECR I-2099 para 58.
See also The Stardust case: Case C-482/99 *French Republic v Commission of the European Communities* [2002] ECR I-04397 para 55-56.

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(v) any other indicator showing an involvement by public authorities in the adoption of a measure or the unlikelihood of them not being involved; and

(vi) the compass of the measure, its content or the conditions which it contains.[128] Hence, no distinction is drawn between cases where aid is directly granted by the state and where aid is granted by public or private bodies established or appointed by the State to administer the aid.[129] Any state aid which is attributable to a member state comes within the ambit of the prohibition and both aid granted by the State and through State resources are thus covered by the notion of state aid.[130]

It has to be pointed out, however, that even when a state aid measure is granted by a member state or through state resources, the state aid measure might still be declared to be compatible with the internal market. This would be the case if the Commission decides that the measure is exempted from the state aid prohibition in terms of Article 107 (2) or Article 107 (3),[131] the Block Exemption Regulation,[132] the de minimuis rule[133] or if the member state successfully argues that the state aid qualifies for exemption in terms of the Market Economy Investor Principle (MEIP) or private investor test.[134]

4 3 State aid must distort or threaten to distort competition and adversely affect trade[135] between member states

These two requirements are "as a general rule inextricably linked", particular when the state aid strengthens the position of an undertaking compared with other

[128] The Stardust case: Case C-482/99 *French Republic v Commission of the European Communities* [2002] ECR I-04397 para 56.
[129] See in this regard Case C-305/89 *Italy v Commission* [1991] ECR I-1603 para 13.
[130] See Case -78/76 *Steinike and Wieinlig v Federal Republic of Germany* [1977] ECR 611.
[131] L Hancher & F Salerno "State aid in the energy sector" in E Szyszcak (ed) *Research Handbook on European State Aid Law* (2011) 246 256.
[132] See the detailed discussion on the Block Exemption Regulation in para 5.1 of this chapter.
[133] See the detailed discussion on the de minimis rule in para 4.5 of this chapter.
[134] See the discussion on the MEIP in para 4. 4 of this chapter.
See also Case C-457/00 *Kingdom of Belgium v Commission of the European Communities* [2003] ECRI-6931 para 45. In this case the Court stated that "in order to determine whether the Commission correctly applied the private investor test it is necessary to ascertain whether a private investor" would have acted as the public authority did in providing the aid.
[135] See Case T-156/04 *Électricité de France (EDF) v the European Commission*[2009] ECR II-4503 paras 144-145; and Case C-222/04 *Cassa di Risparmio di Firenze and Others* [2006] ECR I-289 para 140.

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undertakings competing in intra-Community trade.[136] EU case law has confirmed on a number of occasions that any state aid granted to an undertaking which operates its business in the internal market may cause distortion of competition and affect trade between member states simultaneously.[137]

Therefore negative effects which state aid may have on trade between member states, is as important as the distortive effect it may have on competition.[138] This is shown by the creation of the "effects test" by the CJEU. In *Italy v the Commission*[139] the court said that since the aim of Article 92 (now Article 107) is to protect trade between member states and the prevention of any distortion of competition, the Article does not look at aid measures "by reference to their causes or aims but defines them in relation to their effects".[140] Hence the Commission does not have to prove a "real effect" on trade or that competition is "actually" distorted. If that were the case, "such a requirement would ultimately give Member States which grant unlawful aid an advantage over those which notify the aid at the planning stage."[141] The Commission also does not have to carry out an economic analysis of the actual effects on the relevant market, as long as it explains to the parties involved how the aid is capable of affecting trade and distorting competition.[142] It is therefore only necessary for the Commission to determine whether a measure by a member state has the ability to affect trade between member states or distort competition.[143] No real effect on trade or actual distortion of competition needs to be examined.[144] The Commission only has to explain and provide sufficient reasons for its explanation of

[136] See Case T-288/97 *Regione Autonoma Friuli-Venezia Giulia* v *Commission* [2001] ECR II- 1169 para 41; and Joined Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98 *Alzetta and Others* v *Commission* [2000] ECR II-2319 para 81.
[137] See Case T-189/03 *ASM Brescia* v *Commission* [2009]ECR II-1831 para 68; Joined Cases T-92/00 and T-103/92 *Diputación Foral de Álava* v *Commission* [2002] ECR II-1385 para 72; Case T-222/04 *Italy* v *Commission* [2009] ECR II-1877 para 43; Case 730/79 *Philip Morris v Commission* [1980] ECR 2671 paras 11-12; and Case C-75/97 *Belgium v Commission* [1999] ECR I-3671 paras 47-48.
[138] For more on the criterion that the state aid must adversely affect trade between member state see C Dekker "The Effect on Trade between the Member States' Criterion: Is It the Right Criterion by Which the Commission's Workload Can Be Managed" (2017) 2 *European State Aid Law Quarterly* 154 154-163.
[139] Case 173/73 *Italy v the Commission* [1974] ECR 709.
[140] Case 173/73 *Italy v the Commission* [1974] ECR 718.
[141] Case T- 177/07 *Mediaset v Commission* [2010] ECR 2341 para 145. See also Case T-55/*99 CETM v Commission* [2000] ECR II-3207 para 103; Case T- 152/99 *HAMSA v Commission* [2002] ECR II-3049 para 225; and Case T- 198/01 *Technische Glaswerke Ilmenau v Commission* [2004] ECR II-2717 para 215.
[142] See Case T-177/07 *Mediaset* v *Commission* ECR 2341 para 45.
[143] Case C-222/04 *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA, Fondazione Cassa di Risparmio di San Miniato and Cassa di Risparmio di San Miniato SpA,* [2006] ECRI-289 para 140.
[144] Case C-222/04 *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA, Fondazione Cassa di Risparmio di San Miniato and Cassa di Risparmio di San Miniato SpA,* [2006] ECRI-289 para 140.

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how the aid in question would distort competition and affect trade between member states.[145]

It is thus not the form which the aid measure takes but rather the effect of the aid measure, which determines whether the aid is compatible with the internal market or not. As stated in *Italy v the Commission,*[146] the nature of the aid measure is not sufficient to shield it from the application of the state aid regime. Heidhues and Nitsche states that in the case of other areas of competition policy, the Commission equates any anti-competitive behaviour to "harm to the consumer", while in the case of state aid, the effect of unlawful state aid is equated to "harm to rivals".[147] The authors, however, suggest that the Commission should not only consider the effect on rivals when it has to consider the compatibility of a state aid measure with the internal market, but it should also consider the effect on the welfare of both the rivals of the undertaking that would receive the aid and the consumer.[148]

Although the above two requirements are "as a general rule inextricably linked", EU jurisprudence also give separate content to them. In regard to the requirement that competition must be distorted or threatened to be distorted by the state aid, EU case law presumes that "operating aid"[149] to an undertaking, which provides the undertaking with "artificial financial support", may distort competition in the sector in which it was granted.[150] And whenever the Commission finds that there is "operating aid", the Commission does not have to "explain in minute detail why that aid distorted competition".[151]

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[145] See Case T-152/99 *HAMSA* v *Commission* [2002] ECR II-3049 para 225; and Case T-198/01 *Technische Glaswerke Ilmenau* v *Commission* [2004] ECR II-2717 para 215.
[146] Case 173/73 *Italy v the Commission* [1974] ECR 709.
[147] P Heidhues & R Nitsche "Comments on State Aid Reform - some Implications of an Effects-based Approach" (2006) 1 *European State Aid Law Quarterly* 23 23.
[148] P Heidhues & R Nitsche "Comments on State Aid Reform - some Implications of an Effects-based Approach" (2006) 1 *European State Aid Law Quarterly* 23 23.
[149] Operating aid refers to "aid intended to relieve an undertaking of the expenses which it would itself normally have had to bear in its day-to-day management or its usual activities." Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227 para 114.
[150] Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227 para 114;Case T-459/93 *Siemens* v *Commission* [1995] ECR II-1675 paras 48 and 77; Case T-55/99 *CETM* v *Commission* [2000] ECR II-3207 para 83; C-156/98 *Germany* v *Commission* [2000] ECR I-6857 para 30; and C-288/96 *Germany* v *Commission* [2000] ECR I-8237 paras 77 and 78.
[151] C-288/96 *Germany* v *Commission* [2000] ECR I-8237 para 86.

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In regard to the requirement that state aid must adversely affect trade between member states, it is settled EU law that there is no threshold or percentage below which it may be considered that trade between member states is not affected.[152] Even if the aid is a small amount or if the undertaking which receives the aid is small, it does not necessarily mean that trade between member state might not be affected.[153]

4 4 State aid must favour particular enterprises or production lines: the selectivity criterion

When a member state provides state aid to an undertaking or production line which a private investor under normal market conditions would not have done, it might constitute state aid within the meaning of the state aid prohibition since the member state might be favouring that undertaking or production line.[154] If a state aid measure is not equally applicable to undertakings, but only to particular undertakings or one particular undertaking, even if that undertaking or undertakings are in a comparable factual and legal situation than its competitors, such different treatment might create the condition of selectivity.[155] The Commission states that:

> "…a key aspect to assess selectivity is to determine whether the measure in question is of general application or, on the contrary, applies only to certain undertakings or certain sectors of the economy in a given Member State." [156]

Golfinopoulos states that the question of selectivity is of particular interest when advantages arising from tax schemes are examined by the Commission.[157] This was

[152] Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-7747 para 81.
[153] Case C-142/87 *Belgium v the Commission of the European Communities* [1990] ECR 1-959 para 43.
[154] See the following cases: Case C-39/94 *SFEI and Others* [1996] ECR I-3547 para 60; Case C-342/96 *Spain v Commission* [1999] ECR I-2459 para 41; Case C-142/87 *Belgium v the Commission of the European Communities* [1990] ECR I- 1005 paras 26-27; and Case C-256/97 *DM Trattsport* [1999] ECR I-3913 para 22. See also Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission* ECLI:EU:T:2016:233 para 86-104 discussed in greater detail on other points below. See also A Claici, G Siotis, O Chatterjee & O Stehmann "The Market Economy Investor Principle: Lessons Learned from the Ciudad De La Luz Case 2016 12(1) *Journal of Competition Law and Economics* 181 181-208.
[155] Joined Cases C-20/15 P and C-21/15 P *Commission* v *World Duty Free Group* ECLI:EU:C:2016:981 para 54.
[156] See Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018 para 581.

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seen in a number of recent state aid cases in which tax benefits, which were awarded to undertakings by member states, were scrutinised by the Commission. When the Netherlands provided certain tax benefits to a subsidiary of Starbucks, a multinational corporation, the Commission decided that it was a selective tax advantage since the corporation tax payable by the Starbucks subsidiary in the Netherlands was artificially lowered in an agreement between the entity and the Dutch tax authorities.[158]

In regard to fiscal state aid the CJEU has devised a three-step analysis to determine whether a measure is selective.[159] Firstly, it is necessary to identify and examine the common or 'normal' regime applicable in the member state concerned.[160] Secondly, it is necessary to demonstrate that the tax measure at issue is selective as the measure derogates from the common regime inasmuch as it differentiates between economic operators who are in a comparable factual and legal situation.[161] Thirdly, a determination must be made on whether the 'normal' tax regime applicable in the member state concerned justifies any derogation.[162]

Following this three-step analysis in conjunction with establishing the presence of all the elements needed for state aid to exist, the Commission decided that the agreement between the Starbucks' subsidiary and the Dutch tax authorities conferred a selective advantage on the enterprise for the purposes of Article 107(1) of the Treaty. This was because the individual scheme lowered the company's taxable profit in the Netherlands as compared to other companies whose taxable profits is determined by their market transactions.[163] The existence of all the elements for state aid was confirmed and since the aid was provided in

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[157] C Golfinopoulos "Concept of selectivity criterion in state aid definition following the Adria-Wien judgment - measures justified by the "nature or general scheme of a system"" (2003) 24(10) *European Competition Law Review* 543 544.
[158] See Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks (notified under document C (2015) 7143) *Official Journal of the European Union* No L 83 29/03/2017 38; and "Selective tax advantages for Fiat in Luxembourg and Starbucks in Netherlands declared illegal" 2015 (338) *EU Focus* 22 22-24.
[159] Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* EU:C:2011:550 paras 48-76.
[160] Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* EU:C:2011:550 para 49.
[161] Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* EU:C:2011:550 para 49.
[162] Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* EU:C:2011:550 para 50.
[163] Paras 415-417 of Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks (notified under document C (2015) 7143) *Official Journal of the European Union* No L 83 29/03/2017.

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contravention of the procedural requirements as provided for in Article 108(3) of the TFEU,[164] the aid was unlawful and had to be recovered.[165]

The Commission found similar selective advantages given by Ireland[166] and Luxembourg[167] respectively to other multinational entities. In the Ireland case, two subsidiaries of the Apple Group operate business in Ireland.[168] The Irish tax authorities issued certain tax rulings which the Apple subsidiaries used to calculate their annual corporate tax liability in Ireland. Such calculations were accepted by the Irish tax authorities. [169] The Commission applied the three-step analysis applicable to fiscal benefits and the other requirements for state aid. It concluded that the Irish tax authorities' tax rulings resulted in a lowering of the Apple subsidiaries' corporation tax liability under the ordinary rules of taxation of corporate profit in Ireland as compared to other companies whose corporate tax liability is determined by their transactions in the market. Hence, the tax rulings were considered to be a selective advantage for the purposes of Article 107(1) of the TFEU.[170] The state aid provided to the two Apple subsidiaries were declared to be unlawful as Ireland did not comply with the procedural requirements in regard to the notification of state aid and had to be recovered by Ireland from the two entities.[171]

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[164] See the comprehensive discussion on the procedural rules in para 6 of this chapter.

[165] Paras 435-436 of the Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks (notified under document C (2015) 7143) *Official Journal of the European Union* No L 83 29/03/2017.

[166] Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple *Official Journal of the European Union* No L 187/1 19/7/2017.

[167] See Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018; and "Commission finds Luxembourg gave illegal tax benefits to Amazon worth around EUR 250 million 2017 (361) EU Focus 25 25-26.

[168] Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple *Official Journal of the European Union* No L 187/1 19/7/2017; "Commission rules that Ireland gave illegal tax benefits to Apple worth up to EUR 13 billion" 2016 (348*) EU Focus* 26 26-28; and F Hansen "Taking More Than They Give: MNE Tax Privateering and Apple's "Ocean" Income" 2018 (19) *German Law Journal* 693 693- 725.

[169] Para 221 of Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple *Official Journal of the European Union* No L 187/1 19/7/2017.

[170] Para 361 of Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple *Official Journal of the European Union* No L 187/1 19/7/2017.

[171] Paras 412- 424 of Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple *Official Journal of the European Union* No L 187/1 19/7/2017; "Apple to repay Ireland EUR 13bn of unlawful state aid" 2016 5(6) *Compliance and Risk* 17 17-18.

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The second finding was against Luxembourg which awarded certain tax benefits to Amazon. The Commission found that the tax benefits were awarded under an individual scheme only applicable to Amazon.[172] Hence, there was selectivity as neither Luxembourg nor Amazon could advance any possible justification for the favourable treatment.[173] The advantage awarded to the Amazon subsidiary was thus found to be selective in nature.[174] The Commission further found that the tax ruling by the Luxembourg tax authorities in favour of the Amazon subsidiary satisfies all the conditions of Article 107(1) of the TFEU since it led to a lowering of the entity's corporate income tax liability in Luxembourg.[175] Hence, state aid was awarded unlawfully because there was no compliance by Luxembourg with the procedural requirements in Article 108(3) of the TFEU.[176] Consequently, Luxembourg was ordered to recover the aid from the beneficiary entity.[177]

To verify whether any favouritism of an undertaking or production line exists, that is whether the selectivity requirement is met, the Commission may apply the Market Economy Investor Principle (MEIP).[178] In term of this principle it must be determined whether a private investor under normal market conditions would have acted as the member state did. Described as "the yardstick for the determination of whether measures adopted by public authorities constitutes State aid within the meaning of

[172] Para 583 Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018.
[173] Para 603 Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018.
[174] Para 605 Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018.
[175] Paras 606- 607 Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018.
[176] See the discussion in para 6 of this chapter on the procedural rules relating to the state aid prohibition.
[177] Paras 615- 617 Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon *Official Journal of the European Union* No L 153/2 15/6/2018.
[178] It is also referred to as the private investor test. See Case C-457/00 *Kingdom of Belgium v Commission of the European Communities* [2003] ECRI-6931 para 45.
In this case the Court stated that "in order to determine whether the Commission correctly applied the private investor test it is necessary to ascertain whether a private investor" would have acted as the public authority did in providing the aid. See also Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale v Commission of the European Communities* [2003] ECR II-445 para 34 and M Parish " On the private investor principle" 2003 28(1) *European Law Review* 70 70-89.

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Article 87 (1) EC", the MEIP was first applied to the steel and shipbuilding sectors.[179] The General Court stated in *Dunamenti Eromu Zrt v European Commission*[180] that:

> "…it must be noted that the test of a private operator in a market economy is satisfied where the State in fact merely acts in the same way as any private operator would do acting in normal market conditions. In such circumstances, there is no advantage attributable to intervention by the State, because the beneficiary could theoretically have derived the same benefits from the mere functioning of the market."

Thus simplified, the MEIP concerns the question whether a private investor would invest in the undertaking in the same way the state authority did. If the answer to this question is affirmative, the investment could be seen as part of normal market investment.[181] If the answer, however, is negative, the state aid may qualify as favouritism by the member state towards the particular undertaking. In terms of the MEIP principle, if a financing measure could not be equated with "equity capital according to standard company practice in a market economy" it will be considered state aid and the state aid control regime will be applicable.[182] It is thus important to determine whether the state aid measure falls within the state's capacity as state authority or whether it arise due to the state's responsibility as a shareholder.[183] In this regard the CJEU in *Électricité de France (EDF) v the European Community*[184] stated that it is not the form of the state aid measure, but the nature, subject-matter and the objectives of the measures that are decisive, in determining whether the state acts in its capacity as state authority or shareholder.[185]

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[179] P Anestis & S Mavroghenis "The Market Investor Test" in MS Rydelski (ed) *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade* (2006) 109 109.
[180] Case T-179/09 *Dunamenti Erőmű v Commission* EU:T:2014:236 para 76.
[181] See P Anestis & S Mavroghenis "The Market Investor Test" in MS Rydelski (ed) *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade* (2006) 109 110. See generally also Y Simon "The Application of the Market Economy Investor Principle in the German Landesbanken cases" (2007) 3 *European State Aid Law Quarterly* 499 499- 508.
[182] L Hancher, T Ottervanger & PJ Slot *EC State Aids* (2012) para 8-018.
[183] Case T-156/04 *Électricité de France (EDF) v the European Community* [2009] ECR I-4503 para 229.
[184] [2009] ECR I-4503.
[185] Case T-156/04 *Électricité de France (EDF) v the European Community* [2009] ECR I-4503 para 229.

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The MEIP was first given administrative and judicial recognition by the Commission and the CJEU respectively in 1984 in a case of state aid against Belgium.[186] In 1982 the Belgian government decided to grant assistance through a regional investment body to an undertaking which manufactured equipment for the food industry. It provided capital in the amount of BFR 145 million to the undertaking. The Commission found that the aid granted by the Belgian government was incompatible with the common market (now internal market) and thus not in compliance with Article 92 of the EEC Treaty (now Article 107 of the TFEU) and that the aid should be abolished.[187] The Belgian authorities applied to the CJEU to have the Commission's decision declared void. They argued that by prohibiting them from increasing the capital of the undertaking, the Commission was discriminating against them in comparison with a private shareholder.[188] They further argued that it is normal and legitimate for a shareholder to provide additional capital to support an undertaking which that shareholder controls and which is experiencing temporary difficulties.[189] They also stated that the Commission should have kept this in mind when making its decision on whether the subscription to capital constituted state aid within the ambit of Article 92 of the EEC Treaty. The Commission argued that "the company's financial situation was a handicap which makes it very unlikely that it could have raised the finance it needed to survive on the private capital market".[190] The Commission also noted that the undertaking had experienced financial difficulties for quite some time. Therefore the money injected in the undertaking constituted aid within the scope of the treaty and not a subscription to risk capital as can be found in the market.[191] It further stated that public authorities in their capacity as shareholders are not prevented from supporting an undertaking but if they do provide such support, the competition rules of the Treaty must be observed.[192] The CJEU decided firstly, that the undertaking would not have survived without public

[186] See Commission Decision No 84/496 of 17 April 1984 *Official Journal of the European Communities* No L 276/[1984]; and Case 234/84 *Kingdom of Belgium v Commission of the European Communities* ECR 1986 - 02263.
[187] Article 1 of Commission Decision (84/496/EEC) *Official Journal of the European Communities* No L 276 [1984].
[188] Case 234/84 *Kingdom of Belgium v Commission of the European Communities* [1986] ECR-02263 para 9.
[189] Case 234/84 *Kingdom of Belgium v Commission of the European Communities* [1986] ECR-02263 para 9.
[190] Commission Decision No 84/496 of 17 April 1984 *Official Journal of the European Communities* No L 276 [1984] 35.
[191] Commission Decision No 84/496 of 17 April 1984 *Official Journal of the European Communities* No L 276 [1984] 35.
[192] Case 234/84 *Kingdom of Belgium v the Commission of the European Communities* [1986] ECR- 2263 2285.

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funds, considering its financial results and other determining factors such as its historical development. Secondly, it found that the undertaking's circumstances at that moment would have made it rather difficult for any capital to be obtained in the private market or from a private shareholder.[193] Therefore the provision of capital to the undertaking by the Belgian government was state aid in the "form of a State rescue operation". The CJEU laid down the MEIP by stating that:

> "In the case of an undertaking whose capital is held by the public authorities, the test is, in particular, whether in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional-policy and sectoral considerations, would have subscribed the capital in question."[194]

After acceptance of the MEIP as part of the state aid control regime, there were many instances in which the principle was applied by the court. The principle was used by Germany in *Linde AG v the Commission*[195] when it submitted that granting of the "investment subsidy" to Linde AG for the construction of a production plant for carbon monoxide was purely based on "commercial considerations".[196] The Commission found part of the aid measure to be incompatible with the common market (now internal market). It said that the subsidy conferred an advantage to Linde AG in that it firstly, allowed the undertaking to add another carbon monoxide facility to those it already operated without any costs to it and secondly, the subsidy enabled Linde AG to extend its range of products.[197] This decision by the Commission convinced Germany to apply to the CJEU for the partial annulment of the Commission decision. After examining these transactions the court found that the arrangement between the German government and the recipient undertaking represented a "normal commercial transaction" and that the contested subsidy forms part of that arrangement and is thus justified on commercial grounds.[198] The court further stated that the Commission failed to examine whether "economic operators" in the same position would have been willing to pay the same amount of the

[193] Case 234/84 *Kingdom of Belgium v the Commission of the European Communities* [1986] ECR-2263 2285.
[194] Case 234/84 *Kingdom of Belgium v the Commission of the European Communities* [1986] ECR-2263 2286.
[195] [2002] ECR I-4387.
[196] Case T-98/00 *Linde AG v the Commission of the European Communities* [2002] ECR I-4387 para 28.
[197] Case T-98/00 *Linde AG v the Commission of the European Communities* [2002] ECR I-4387 para 34.
[198] Case T-98/00 *Linde AG v the Commission of the European Communities* [2002] ECR I-4387 paras 49-50.

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"investment subsidy".[199] The court consequently decided that the Commission failed to prove to "the requisite legal standard" that the arrangement between the German government and the recipient undertaking of the "investment subsidy" was state aid as prohibited by the Treaty.

Ryanair v the Commission of the European Communities[200] is another case which proves that the principle has now become an established part of state aid assessments. The MEIP became part of the Commission's analysis to determine the legality of state aid measures and member states also started to use the principle as a defence to validate state aid. This case involved two agreements entered into by Ryanair in 2001. The first agreement was with the Walloon Region, the owner of the Charleroi airport in Belgium (the Walloon Region agreement) and the other was with an airport, the Brussels South Charleroi Airport (the Charleroi agreement) which is described in the case as a "public sector company controlled by the Walloon Region". The Walloon Region agreement granted a reduction of at least fifty percent in landing charges to Ryanair and changed the airport opening hours in order to accommodate Ryanair. The agreement also provided for compensation of loss Ryanair might have suffered in the event that the reduced airport charges or the changed opening hours affected its profits. In terms of the Charleroi agreement Ryanair agreed to have between two and four aircrafts on a permanent basis at the Charleroi airport and to use every aircraft for at least three rotations per day for at least fifteen years and in the event that it withdrew from the airport that it would pay certain reimbursement.[201] The agreement also made provision for a contribution by the Charleroi airport for all cost which Ryanair would incur while establishing its base at the airport.[202] The Commission, however, became aware of the advantages awarded to Ryanair after receiving complaints and through the media, at which point it informed Belgium of its decision to start the procedural actions provided for in Article 108 of the TFEU Treaty. It argued that since the Walloon Region and the Charleroi airports were operated by the Belgian government and are consequently governed by the EU state aid control regime, all advantages awarded to Ryanair

[199] Case T-98/00 *Linde AG v the Commission of the European Communities* [2002] ECR I-4387 para 52.
[200] Case T-196/04 *Ryanair v the Commission of the European Communities* [2008] ECR II-364.
[201] Case T-196/04 *Ryanair v the Commission of the European Communities* [2008] ECR II-364 paras 4-7.
[202] See Case T-196/04 *Ryanair v the Commission of the European Communities* [2008] ECR II-364 paras 7-8 for more of the advantages awarded to Ryanair in terms of the Charleroi agreement.

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were supposed to be notified to the Commission, which did not happen. In assessing the advantages the Commission refused to apply the MEIP. It argued that the fixing of the landing charges was not an economic activity but that the Walloon Region exercised a "legislative and regulatory competence". It thus concluded that the advantages awarded to Ryanair were aid within the ambit of the Treaty. Ryanair contested the Commission's decision before the CJEU. The Court stated that a distinction has to be drawn between the state acting in the same way as a private investor and its actions as a public authority. In the event that it acts as a public authority, the application of the private investor principle is excluded as the conduct of the State can never be compared to that of a private investor in a market economy.[203] The court decided even though a body with regulatory powers to fix airport charges enters into a scheme which reduces airport charges, it does not automatically disqualify its activities from being examined by using the private investor principle, as such a scheme could also possibly have been put in place by a private operator.[204] It decided that the Commission erred in not applying the private investor principle to the aid measures.[205]

4 5 The de minimis rule

It would be impractical for the Commission to look into every single state aid measure within the EU on its own initiative. Not only would this create an impossible workload for the Commission but it may also lead to a situation where the Commission might adopt a pick-and-choose approach in regard to the state aid it wishes to investigate. This can cause some harmful instances of state aid to escape scrutiny by the Commission. Beside a pick-and-choose approach, the Commission might be unaware of planned state aid measures by a member state as the member state might have neglected its Treaty duty of notifying the aid to the Commission.[206]

[203] Case T-196/04 *Ryanair v the Commission of the European Communities* [2008] ECR II-364 para 85.
[204] Case T-196/04 *Ryanair v the Commission of the European Communities* [2008] ECR II-364 para 101.
[205] See F Gröteke & W Kerber "The Case of Ryanair - EU State Aid Policy on the Wrong Runway" (2004) 55 *ORDO: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft* 313 313-332 for a complete discussion of the Ryanair case.
[206] See for example the case of *Ryanair v the Commission of the European Communities* ECR II-364 in which instance the Commission was not informed by the member state of the planned state aid measure but learned of such aid through the complaints and the media.

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This and other reasons noted by the Commission, which include an effort to reduce the administrative burden on the member states and on the Commission and to simplify matters for SMEs,[207] led to the implementation of the de minimis rule as part of EU state aid law. In accordance with the de minimis rule, thresholds are set for state aid which may be granted to undertakings by member states without such aid measure having to be notified in advance to the Commission.[208] In essence the de minimis rule aims to place small amounts of state aid, which is unlikely to have an "appreciable effect" on competition and trade within the internal market, outside of the scope of the state aid prohibition. Aid without an "appreciable effect" on trade and competition between Member States and below a certain amount is thus not considered to be state aid within the meaning and scope of Article 107 of the TFEU.

Council Regulation (EC) No. 994/98[209] allowed the Commission to decide by means of regulation that certain aid does not meet the criteria as stated in Article 107 (1) and thus the Commission may exempt such aid measure from compliance with the procedural rules if it does not exceed a certain amount.[210]

Consequently, the Commission adopted its first Regulation which dealt with small amounts of aid to undertakings in 2001.[211] This became known as the de minimis rule. The purpose of the de minimis rule has been described by the Court of Justice[212] as follows:

> "…it should be borne in mind that the de minimis rule is intended to reduce the administrative burden on both the Member States and the Commission, which must be able to concentrate its resources on cases that are genuinely important at Community level."

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[207] See Commission notice on the de minimis rule for State aid *Official Journal of the European Communities* No C 68/9 [1996].
[208] Commission notice on the de minimis rule for State aid *Official Journal of the European Communities* No C 68/9 [1996].
[209] See the discussion on this Regulation in para 5.2 of this chapter.
[210] See Article 2 of Council Regulation (EC) No. 994/98 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid *Official Journal of the European Communities* No L 142/1 [1998].
[211] Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid *Official Journal of the European Communities* No L 10/30 [2001].
[212] Case C 310/99 *Italy v Commission* [2002] ECR I- 2289 para 94.

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The investigation of aid measures which are relatively small, with little or no impact on competition and trade between members state, can unnecessarily take up the Commission's time and resources which could have been directed to more problematic aid measures.[213]

The first de minimis Regulation was revised in 2006[214] and again in 2013[215] with the last version of the Regulation valid until 2020, but this involved only a few changes to the basic rules regarding de minimis exemptions.

In terms of the de minimis Regulation any aid measures which falls within the thresholds set by the Commission shall be deemed not to meet all the criteria of Article 107 (1) of the TFEU and shall therefore not fall under the notification requirement of Article 108(3) of the Treaty. An undertaking is allowed to receive from a member state an amount of EUR 200 000.00 as de minimis aid over a period of three years.[216] This threshold applies irrespective of the form of the de minimis aid or the objective pursued by the undertaking to which the aid is granted.[217] Undertakings in all sectors of the single market benefits from the application of the de minimis rule with some exceptions.[218]

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[213] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009) 397.

[214] Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid *Official Journal of the European Communities* No L 379/5 [2006].
See also M Berghofer "The New De Minimis Regulation: Enlarging the Sword of Damocles*"* (2007) 1 *European State Aid Law Quarterly* 11 11-24 for more on the 2006 De Minimis Regulation.

[215] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid *Official Journal of the European Union* No 352/1 [2013].

[216] Article 3 of Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid *Official Journal of the European Union* No 352/1 [2013].
The first threshold set by the Commission in 2001 was a ceiling of EUR 100 000 over any period of three years. See the Preamble of Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid *Official Journal of the European Communities* No L 10/30 [2001].

[217] Article 3 of Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid *Official Journal of the European Union* No 352/1 [2013].

[218] The exceptions include: (a) aid granted to undertakings active in the fishery and aquaculture sector, b) aid granted to undertakings active in the primary production of agricultural products; (c)aid granted to undertakings active in the sector of processing and marketing of agricultural products under certain circumstances; (d) aid to export-related activities towards third countries or Member States; and (e) aid contingent upon the use of domestic over imported goods. See Article 1 of Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid *Official Journal of the European Union* No 352/1 [2013].

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Unlike the Block Exemption Regulation[219] (BER) which focuses on exempting state aid to certain sectors of the member states' economies from the state aid control rules, by declaring them compatible with the internal market, the de minimis rule focuses on those aid measures which are considered not to meet all the criteria of Article 107 (1) because of the actual amount of aid allocated to an undertaking.[220] Hence no declaration of compatibility is necessary. Aid which qualifies as exempted aid in terms of the BER may therefore still impact on competition and trade, but due to the block exemption it is considered to be compatible with the internal market. De minimis aid on the other hand, is deemed not to impact on competition and trade due to its insignificance and therefore does not meet the criteria of Article 107 (1) of the TFEU.

The de minimis rule and how it is applied has not been without criticism. Rubini argues that an insignificant amount of aid does not necessarily mean that it does not have the ability to distort competition.[221] Rubini further argues that the focus should instead be on the beneficiary and its economic situation at the moment the aid is awarded as the "same amount may mean different things to different recipients".[222] The author argues that the market power of the undertaking at the time of the aid should be a determining factor on whether the aid could be distortive and not the amount of the aid.[223] It is submitted that Rubini is correct to observe that even small amounts of aid could still contravene Article 107(1) of the TFEU despite the objectives with this form of exemption. It is further submitted that even a small aid measure could place an existing competitor in a better position than its competitors or creates the ability to block any new entrants from a market. Nevertheless, the risk that this will happen is considerably reduced as the amounts of aid become smaller.

It is submitted that in a modern and expanded EU, group exemptions and monetary thresholds to the state aid prohibition was to be expected, since the Commission is

[219] See the discussion in para 5.2 of this chapter.
[220] See Article 1 and 2 of Council Regulation (EC) No 994/98 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid *Official Journal of the European Communities* No L 142/1 [1998].
[221] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009) 398.
[222] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009) 398.
[223] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009) 398.

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the only EU institution which is empowered to determine the compatibility of state aid measures with the internal market. When the founding treaty was enacted in 1957, such a responsibility would not have placed immense pressure on the Commission since there were only six member states involved. But if the Commission today have to investigate every single state aid measure, it could take up too much of the Commission's resources and time.

5 Aid exempted from the state aid prohibition

5 1 Introduction

Articles 107 (2)[224] and (3)[225] of the TFEU[226] exempt certain state aid measures from the state aid prohibition. The Commission also regularly reviews the categories of aid which could be exempted because of the power it has in terms of Article 107 (3) (e) of the TFEU, which allows the Commission to exempt state aid measures from the state aid prohibition. As a result of this power, regulatory instruments which exempt certain state aid measures from the state aid prohibition were issued and implemented by the Commission. Hence, exemptions may be "mandatory" in Article 107 (2) and "discretionary" in Article 107 (3). Discretionary exemptions may be either in terms of the more specific criteria set out in section 107(3)(a)-107(3)(d) or in terms of the more general section 107(e). This section will first look at the practically most important more specific Regulation by which exemption is given, the Block Exemption Regulation. Thereafter exemptions for rescue measures especially those

[224] State aid measures exempted in terms of this article are: "(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point."

[225] State aid measures exempted in terms of this article are: "(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest; (e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission." See the discussion below in par 5.3 of this chapter how the Commission may apply its discretionary powers in regard to these type of exemptions.

[226] SM Colino *Competition Law of the EU and the UK* 7 ed (2011) 420- 425 for a detailed discussion on these exemptions'. See also K Middleton, B Rodger, A MacCulloch & J Galloway *Cases and Materials on UK and EC Competition Law* 2 ed (2009) 598.

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that applied in the 2008 financial crisis will be analysed. Not only was the financial crisis the most significant test for the European state aid regime but rescue measures are particularly relevant to state aid of SOEs in South Africa. Next, a few observations about Guidelines and other similar measures regarding exemptions will be made. Finally, the status of exempting legislation outside of the state aid regime will be considered.

5 2 The Block Exemption Regulation (BER)

Whenever state aid measures meet the criteria listed in Article 107 (1) of the TFEU, such funding cannot be implemented by the member state without notifying the Commission.[227] The European Council, however, has the power to declare that certain categories of aid are exempted from the notification requirement. In terms of Article 109 of the TFEU, after having received a proposal from the Commission, the Council may make any appropriate regulations which may address the application of the state aid rules. Article 109 further states that the Council may adopt regulations which exempt categories of state aid from the application of the notification procedure.[228]

After having received a proposal[229] from the Commission, the Council adopted its first "enabling regulation"[230] in 1998. It empowered the Commission to declare that certain categories of state aid measures were exempted from the notification requirement.[231] In its proposal at the time, the Commission stated that "state aid can be used to replace barriers to trade that have been dismantled in the single market integration process."[232] Hence, it wanted a more effective state aid control regime in which its resources would be directed and used in assessing the most "distorting

[227] See para 6 of this chapter for a comprehensive discussion of the notification requirement.
[228] See the discussion in para 6 of this chapter on the procedural rules.
[229] See Proposal for a Council Regulation (EC) on the application of Article 92 and 93 of the EC Treaty to certain categories of horizontal State aid *Official Journal of the European Communities* No C 262 [1997] 6–9
[230] See Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid *Official Journal of the European Communities* No L 142/1 [1998].
[231] See Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid *Official Journal of the European Communities* No L 142/1 [1998].
[232] Para 1 of the Proposal for a Council Regulation (EC) on the application of Article 92 and 93 of the EC Treaty to certain categories of horizontal State aid *Official Journal of the European Communities* No C 262 [1997].

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cases" of state aid.[233] The Commission wanted "efficient supervision" and simplified administration of the state aid regime which would not weaken its monitoring. The Commission also wanted a system that would bring about a reduction in the general levels of aid allocated by member states.[234] It felt that block exemptions would best achieve these aims and increase transparency and legal certainty.[235] Some of the reasons listed in the Commission's proposal for more "effective and strict state aid control" included (i) globalisation, (ii) technological development, (iii) the completion of the single market, (iv) enlargement of the EU, (v) unemployment levels, since the Commission felt that member states would use state aid as a tool to combat unemployment and (vi) the need to complement the fundamental freedoms of the EU.[236] The Commission thus wanted to ensure that the state aid controls were sufficient to keep up with all the above developments.

As a result the Commission issued its first regulations on state aid measures which could be deemed compatible with the internal market and thus be exempted from the notification obligation in Article 108 (3) of the TFEU. The initial sectoral regulations which were issued by the Commission only provided exemption to specific sectors[237] where the Commission had sufficient experience to define general compatibility criteria.[238] Consequently there was initially no general block exemption regulation for state aid measures. This was in stark contrast with antitrust rules in European

[233] Para 3 of the Proposal for a Council Regulation (EC) on the application of Article 92 and 93 of the EC Treaty to certain categories of horizontal State aid *Official Journal of the European Communities* No C 262 [1997].
[234] Para 2 of the Proposal for a Council Regulation (EC) on the application of Article 92 and 93 of the EC Treaty to certain categories of horizontal State aid *Official Journal of the European Communities* No C 262 [1997].
[235] Para 2 of the Proposal for a Council Regulation (EC) on the application of Article 92 and 93 of the EC Treaty to certain categories of horizontal State aid *Official Journal of the European Communities* No C 262 [1997].
[236] Para 1 of the Proposal for a Council Regulation (EC) on the application of Article 92 and 93 of the EC Treaty to certain categories of horizontal State aid *Official Journal of the European Communities* No C 262 [1997].
[237] Examples include Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium sized enterprises *Official Journal of the European Communities* No L 10/33 [2001]; Commission Regulation (EC) No 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment *Official Journal of the European Communities* No L 337/3 [2002]; and Commission Regulation (EC) No 1628/2006 of 24 October 2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid *Official Journal of the European Union* No L 302/29 [2006].
[238] See para 4 of the Preamble of Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid *Official Journal of the European Communities* No L 142/1 [1998] where such experience by the Commission is mentioned.

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competition policy. The Commission has been empowered to grant general block exemptions to certain categories of agreements, decisions and concerted practices between undertakings since 1965.[239] Several such exemptions had been granted.[240]

Individual exemption regulations were issued until the Commission issued its first General Block Exemption Regulation (GBER 2008)[241] for state aid measures in 2008.[242] The GBER applied across all sectors.[243] Described as an "important tool of simplification and prioritization", the GBER 2008 defined the type of state aid measures that did not have to be notified to the Commission. State aid measures listed in the GBER 2008 were not only exempted from the notification requirement but they were also considered to be compatible with the internal market,[244] even though they may have met all the requirements of the state aid prohibition.[245]

The GBER 2008 has now expired[246] and was replaced with a new block exemption regulation (BER 2014).[247] While the exemptions in the GBER 2008 covered a wide range of aid measures across a number of fields such as (i) regional aid; (ii) SMEs investment and employment aid; (iii) aid for the creation of enterprises by female entrepreneurs; (iv) aid for environmental protection; (v) aid for consultancy in favour of SMEs and SME participation in fairs; (vi) aid in the form of risk capital; (vii) aid for

[239] See Regulation No 19/65/EEC of the Council of 2 March 1965 on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices *Official Journal of the European Communities* No 533/65 [1965].
[240] See Article 3 of the Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices *Official Journal of the European Union* No L 102/1 [2010] which exempts vertical agreements for the purchase of sale of goods or services when the agreements are concluded between non-competing undertakings, between certain competitors or by certain associations of retailers of goods. Vertical agreements which contain ancillary provisions on the assignment or use of intellectual property rights are also regarded as satisfying the conditions in Article 101 (3) of the TFEU.
[241] For more on the GBER 2008 see M Berghoger "The General Block Exemption Regulation: A Giant on Feet of Clay" (2009) 8(3) *European State Aid Law Quarterly* 323 323-336.
[242] See Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation) *Official Journal of the European Union* No L 214/3 [2008].
[243] See para 9 of the Preamble of the Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation) *Official Journal of the European Union* No L 214/3 [2008].
[244] See K Deiberova & H Nyssens "The new General Block Exemption Regulation (GBER): What changed?" (2009) 1 *European State Aid Law Quarterly* 27 27-38.
[245] See Article 107 (1) of the TFEU.
[246] This regulation was supposed to be in force until 31 December 2013 but was prolonged by a Commission amendment until June 2014.
[247] See Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014] for the BER 2014.

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research, development and innovation; (viii) training aid; and (ix) aid for disadvantaged or disabled workers,[248] the scope of the BER 2014 is even wider. This is because the Council empowered the Commission to extend the block exemption to a number of new categories of aid.[249] The new categories of aid which were included by the BER 2014 are (i) aid to make good the damage caused by certain natural disasters; (ii) social aid for transport for residents of remote regions; (iii) aid for broadband infrastructures; (vi) aid for culture and heritage conservation; (v) aid for sport and multifunctional recreational infrastructure; (vi) aid for local infrastructures; (vii) aid for regional airports; and (viii) aid for ports.[250]

Most of the exempted aid measures are however subjected to certain thresholds.[251] Member states are also not allowed to circumvent these thresholds by artificially splitting up the aid schemes or aid projects.[252]

Various checks and balances have also been built into the BER 2014 (such measures were also in the GBER 2008) in order to ensure that member states do

[248] See Article 1 of Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation) *Official Journal of the European Union* No L 214/3 [2008] for the scope of GBER 2008 application.

[249] See Council Regulation (EC) No 1588/2015 of 13 July 2015 *Official Journal of the European Union* No L 248/1 [2015]. See also the Preamble of Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014].

[250] See Article 1 of Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014]. See also Commission Regulation (EU) 2017/1084 of 14 June 2017 amending Regulation (EU) No 651/2014 as regards aid for port and airport infrastructure, notification thresholds for aid for culture and heritage conservation and for aid for sport and multifunctional recreational infrastructures, and regional operating aid schemes for outermost regions and amending Regulation (EU) No 702/2014 as regards the calculation of eligible costs *Official Journal of the European Union* No L 156/1 [2017] which amended the BER 2014 and added certain aid measures to ports and airports to qualify under the exemption.

[251] See Article 4 of Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014]. The thresholds are, inter alia, as follow: (i) for regional investment aid not more than EUR 100 million; (ii) for regional urban development aid not more than EUR 20 million; (iii) for investment aid to SMEs: EUR 7,5 million per undertaking per investment project; (v) for aid for consultancy in favour of SMEs: EUR 2 million per undertaking, per project; (vi) for aid to SMEs for participation in fairs: EUR 2 million per undertaking, per year; (vii) for aid to SMEs for cooperation costs incurred by participating in European Territorial Cooperation projects: EUR 2 million per undertaking, per project; and (viii) for risk finance aid: EUR 15 million per eligible undertaking.

[252] Article 4(2) of Commission Regulation (EU) No. 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014].

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not award aid outside of the exemptions without complying with the procedural requirements of the state aid control regime. These include that:

(i) member state must submit the summary information about each aid measure exempted in terms of the BER 2014, together with a link providing access to the full text of the aid measure, including its amendments, within 20 working days following its entry into force to the Commission;[253]

(ii) member states must maintain detailed records with the information and supporting documentation of the state aid measure and such records have to be kept for ten years from the date on which the *ad hoc* aid was granted or the last aid was granted under the scheme;[254] and

(ii) member states, on request, must provide the Commission with any requested information and supporting documents regarding the state aid measure within a period of 20 working days from receipt of the request or such longer period as may be fixed in the request.[255]

By implementing block exemptions, the Commission's workload has been lightened. It can now focus its attention on those state aid measures which severely distorts competition and impacts on trade between member states. The block exemptions can also be applied by the national courts of the member states when complaints are received.[256] This is because the criteria for compatibility with the internal market were codified in the BER, which makes it easier for national courts to establish whether an infringement of the state aid rules has indeed occurred. When there is a complaint about a state aid measure, the national courts can thus consult the BER to determine whether such measure is covered by the scope of the BER.

5 3 Rescue measures especially in the 2008 financial crisis as an example

[253] Article 11 of the Commission Regulation (EU) No. 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014].
[254] Article 12 (1) of Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014].
[255] Article 12 (3) of Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty *Official Journal of the European Union* No L187/1 [2014].
[256] See the discussion on the enforcement of the state aid rules in para 8 of this chapter.

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Many governments provide state aid as a rescue measures during crises. One such crisis was the 2008 global financial crisis. During the 2008 crisis many governments provided state aid to undertakings whose failure would have crippled the financial system and could have led to widespread failures of enterprises.[257] Many of these enterprises were private undertakings in which the governments previously held no equity. Yet the "too big to fail" argument was used as a justification to provide state aid to rescue these undertakings from failing as the failure of a big firm could have a contagion effect.

Since the crisis originated in the US, some of the largest financial institutions in the US had to be rescued from financial collapse by the government. While Lehman Brothers went into bankruptcy in September 2008,[258] many other big US banks were saved from collapse through a number of methods. Merryl Lynch was acquired by the Bank of America,[259] American International Group (AIG), which was at the time the world largest insurance company, was provided with "immediate liquidity assistance" by the Federal Reserve[260] which saved it from collapse, Bear Sterns were saved from collapse through a "government assisted sale to JP Morgan[261] in March 2008, after it "was forced to sell itself"[262] and by September 2008 Morgan Stanley and Goldman Sachs each received a Federal Reserve bailout of 96.1 billion Dollars and 31.5 billion Dollars respectively.[263]

Outside of the US, many EU member states also provided aid through rescue packages to safe enterprises from failure. The following are salient examples:

- The British government provided aid to financial institutions such as Northern Rock bank[264] and the Royal Bank of Scotland;[265]

[257] C Graham *EU and UK Competition Law* (2010) 335.
[258] See P Angelides *Financial Crisis Inquiry Report* (2011) 324- 343. See also RS Karmel "A law professor's perspective on 'too big to fail'" (2014) 15(3-4) *Journal of Banking Regulation* 227 227.
[259] BS Bernanke *The Federal Reserve and the Financial Crisis* (2013) 73.
[260] See P Angelides *Financial Crisis Inquiry Report* (2011) 344-352. See also BS Bernanke *The Federal Reserve and the Financial Crisis* (2013) 73.
[261] ML Schapiro *Lehman Brother's Examiner's Report: Congressional Testimony* (2014) 3. See also BS Bernanke *The Federal Reserve and the Financial Crisis* (2013) 72.
[262] BS Bernanke *The Federal Reserve and the Financial Crisis* (2013) 75. See also P Angelides *Financial Crisis Inquiry Report* (2011) 280- 308.
[263] P Angelides *Financial Crisis Inquiry Report* (2011) 354.
[264] H Pym *Inside the Banking Crisis: The Untold Story* (2014) 11- 42.

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- The German government provided state aid to the Hype Real Estate Group, one of its biggest financial institutions;[266] and

-ABN AMRO was partially nationalised by the Dutch government.[267]

Within the EU as a supranational institution, however, rescue aid by a member state may distort competition and affect trade between member states. Therefore the Commission generally deals with such measures within the confines of the state aid prohibition and its Guidelines on state aid for rescuing and restructuring firms in difficulty.[268] The Commission's original guidelines of 1994 recognised that there are certain circumstances when state aid to rescue and restructure firms in difficulty may be justified.[269] Article 107 (3) (b) of the TFEU also allows the Commission to consider certain aid compatible with the internal market if the aid may "remedy a serious disturbance in the economy of a Member State". Together, the Commission's Guidelines and Article 107 (3) b) form the basis for an exemption when there is the need for rescue and restructuring aid. Even with this exemption in place, the Commission views the 'one time, last time' principle[270] as important in this context,

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[265] See the House of Commons report: Banking Crisis: Dealing with the Failure of the UK Banks: Seventh Report of Session 2008-09 *TSO* 19. For more on the position in regard to Northern Rock see HS Shin "Reflections on Northern Rock: The Bank Run That Heralded the Global Financial Crisis" (2009) 23(1) *Journal of Economic Perspectives* 101-120. See also C Graham *EU and UK Competition Law* (2010) 336.

[266] See A Christoph Z Keve "Hype Real Estate Group – the longest Chain of German State Aid Measure" (2011) 1 *European State Aid Law Quarterly* 9 9-11 for a discussion on state aid allocated by the German Federal government to Hypo Real Estate.

[267] The Dutch government only nationalised the part of the bank which was owned by the Belgian Fortis bank by buying all Fortis's activities in the Netherlands: ANB Amro was taken over in 2007 by an international consortium consisting of the Royal Bank of Scotland, Santander, a Spanish bank and the Belgian Fortis Bank. See W Kickert "How the Dutch government responded to the financial, economic and fiscal crisis" (2012) 32(6) *Public Money and Management* 439. See also Y Fassin & D Gosselin "The Collapse of a European Bank in the Financial Crisis: An Analysis from Stakeholder and Ethical Perspective" (2011) 102(2) *Journal of Business Ethics*, 169 169- 170; and J Raab & P Kenis "Heading toward a Society of Networks Empirical Developments and Theoretical Challenges" (2009) 18(3) *Journal of Management Inquiry* 198 198.

[268] The Commission issued its first guidelines in 1994 and issued reviewed versions in 1997, 2004 and 2014. See Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty *Official Journal of the European Communities* No C 368 / 12 [1994]; Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty *Official Journal of the European Communities* No C 283/2 [1997]; Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty *Official Journal of the European Union* No C 244/2 [2004]; and Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty *Journal of the European Union* No C 249/1 [2014].

[269] See Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty *Official Journal of the European Communities* No 368/12 [1994]. These original guidelines of 1994 have now expired but had been replaced by new ones.

[270] The 'one time, last time' principle determines that undertakings should receive rescue and restructuring aid only once within 10 years and only in regard to one restructuring operation. See paras 8 and 70 of Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty *Journal of the European Union* No C 249/1 [2014].

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as it wants to avoid that undertakings which may anticipate that they are likely to be rescued when they run into difficulty, embark on "excessively risky and unsustainable business strategies." Also, Soltesz and Kockritz state that rescue aid to undertakings by member states is "generally perceived very critically by the Commission" and that failing firms should be allowed to exit the market if such failing is due to normal and unhampered competition. Hence rescue and restructuring aid should only be allowed in exceptional circumstances[271] under specific conditions set by the Commission which the Commission deems "necessary to ensure that the aid does not distort competition".

The financial crisis of 2008 was one of integrated Europe's biggest challenges since World War Two. Since rescue aid during the crisis could be justified on the basis of the systemic risk that was posed to the economies of member states as well as the wider integrated EU economy, a uniform and coordinated approach on state aid to those undertakings in distress had to be adopted. Nicolaides and Rusu state that the Commission had to intervene when member states were injecting capital into banks during the crisis.[272]

Although each member state may have experienced the financial crisis differently due to the peculiarity of its economy, it was necessary that a supranational framework had to be created to ensure member state acted within the scope of the state aid rules when providing state aid to financial institutions.[273] The Commission was also aware that if member states had to act on their own without a coordinated approach during the crisis, a "subsidy race" between them could ensue and that it could harm the internal market.[274] The Commission wanted to prevent such a scenario from materialising. It also wanted to avoid any state intervention which would have undermined the objectives of less state aid as envisage by the SAAP.[275] Consequently the Commission issued various regulatory instruments on temporary

[271] U Soltesz & C Von Kockritz The "temporary framework" - the Commission's response to the crisis in the real economy" (2010) 31(3) *European Competition Law Review* 106 107.
[272] P Nicolaides & IE Rusu "The financial crisis and state aid" (2010) 55(4) *Anti-trust Bulletin* 759 760.
[273] See for example J Dzialo "State Aid in the European Union in the Period of the Economic Crisis" (2014) 17(1) *Comparative Economic Research* 5 10 on how the state aid increased in the member states during the crisis in comparison with the year before the financial crisis.
[274] Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Communities* No C16/1 [2009].
[275] See Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Communities* No. C16/1 [2009].

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state aid measures which could be used by member states in order to assist financial institutions during the crisis.[276] The legal basis for these regulatory instruments is Article 107 (3) (b) of the TFEU which provides that aid "to remedy a serious disturbance in the economy of a Member State" may be considered to be compatible with the internal market. The Commission wanted to (i) unblock bank lending to companies and thus guarantee continuity in their access to finance and (ii) encourage companies to continue investing in the future.[277] The temporary state aid measures, that were allowed during the financial crisis, inter alia, included (i) aid which exceeded the de minimis allowance which is set in the de minimis Regulation, as long as it conformed to certain requirements, which included that no more than EUR 500 000 could be granted per undertaking;[278] (ii) subsidised loan guarantees granted for a limited period, because the Commission view it as "an appropriate and well targeted solution to give firms easier access to finance";[279] (iii) public or private loans granted to companies at a beneficial interest rate;[280] (iv) aid in the form of an "interest-rate reduction" for the production of "green products;[281] and a temporary adaptation of the limits which are allowed for state aid to promote risk capital investments in small and medium-sized enterprises.[282]

These measures ensured a coordinated response to the financial crisis by member states. Therefore any aid falling within the ambit of the temporary measures was not in contravention of the state aid rules and thus considered not to affect competition

[276] See Communication from the Commission on the application from 1 August 2013 of the State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') *Official Journal of the European Union* No216/1 [2013]; Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No C 16/01 [2009]; The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis *Official Journal of the European Union* No C 270/02 [2008]. See also P Nicolaides & IE Rusu "The financial crisis and state aid" (2010) 55(4) *Anti-trust Bulletin* 759 760; and U Soltesz & C Von Kockritz The "temporary framework" - the Commission's response to the crisis in the real economy" (2010) 31 (3) *European Competition Law Review* 106 106- 116.

[277] Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Communities* No C16/1 [2009]

[278] Para 4.2.2 of the Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No C 16/01 [2009].

[279] Para 4.3.2 of the Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No C 16/01 [2009].

[280] Para 4.4.2 of the Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No C 16/01 [2009].

[281] Para 4.5.2 of the Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No C 16/01 [2009].

[282] Para 4.6.2 of the Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis *Official Journal of the European Union* No C 16/01 [2009].

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and trade between member states. Monitoring and reporting measures were put in place to ensure that member states stayed within the temporary framework when they provided aid measures.

With its regulatory instruments the Commission thus made it possible for member states to respond immediately to the crisis to limit the impact on their economies and the wider EU economy and it ensured that member states did not breach the state aid prohibition.

5 4 Guidelines and similar instruments

The Commission issues Guidelines and other similar instruments to give clarity on the types of activities that will be exempted from the state aid provisions. Some of these Guidelines apply to specific sectors while others apply across sectors.[283] It has been stated that "according to settled case-law, in the specific area of State aid, the Commission is bound by the guidelines and notices that it issues, to the extent that they do not depart from the rules" of the Treaty.[284] Guidelines accordingly will be used to determine whether the conduct of a person falls within an exemption.[285] Member states and beneficiaries of aid will have to study these Guidelines carefully if they do not want to run the risk that the aid will be declared incompatible with the internal market.

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[283] Examples are: Framework for State aid for research and development and innovation (2014/C 198/01); The EU Guidelines for the application of State aid rules in relation to the rapid deployment of broadband networks 2013/C 25/01 especially para 2.5; Communication from the Commission on State aid for films and other audiovisual works (2013/C 332/01); Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest (2014/C 188/02); Guidelines on State aid to promote risk finance investments 2014/C 19/04; See also above for the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (2014/C 249/01). See especially Guidelines on State aid for environmental protection and energy 2014-2020 (2014/C 200/01) and Guidelines on regional State aid for 2014-2020 (2013/C 209/01) the impact of the predecessors of these Guidelines will be discussed below.

[284] Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 para 127 with reference to Case C-464/09 P *Holland Malt v Commission* ECR, EU:C:2010:733 para 47.

[285] See Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 which is dealt with in greater detail for other reasons below. Para 120-139 deals with the application of Guidelines on National Regional Aid *Official Journal of the European Communities* No. C 74/9 [1998] and 140-160 deals with Community guidelines on State aid for environmental protection *Official Journal of the European Communities* No C 37/3 [2001] and Community guidelines on State aid for environmental protection *Official Journal of the European Communities* No C 72/3 [1994]. In its decision the Commission, for example, gave many reasons why the tax exemption fell short of the Guidelines, Commission Decision of 7 December 2005 concerning the exemption from excise duty on mineral oils used as fuel for alumina production in Gardanne, in the Shannon region and in Sardinia respectively implemented by France, Ireland and Italy Official Journal of the European Union No L 119/12 [2006]..

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5 5 Exemptions in and outside of the state aid regime

It may in the EU be very difficult to determine when and to what extent conduct will be exempted. This is well illustrated by three cases[286] dealing with a tax exemption from excise duty on mineral oils in Gardanne, France, the Shannon region in Ireland and in Sardinia, Italy. These regions in the respective member states, all produce alumina, a white powder which is extracted from bauxite by a refining process and then it is used to produce aluminium. Mineral oils may be used as fuel for alumina production. There is only one producer of alumina in each of Ireland, Italy and France. In Ireland the exemption applies to an undertaking called Aughinish which is located in the Shannon region, in Italy the exemption applies to Eurallumina which is located in Sardinia and in France the exemption applies to an alumina refinery which is located in the Gardanne region. All three companies are located in areas that are eligible for regional aid.[287]

The Irish Republic has since May 1983 exempted oils used for the production of alumna, from excise duty.[288] In terms of a Council Directive of 1992 harmonised rates of excise duties had to be imposed on mineral oils.[289] However, the exemption by Ireland from this requirement, was authorised by the Council in October 1992 in accordance with the Directive.[290] There were several further decisions by the Council to extend the authorisation and the last decision extended it until 31 December 2006. The Italian Republic has since 1993 exempted these mineral oils used as fuel for the production of alumina in Sardinia from excise duty.[291] The exemption was similarly

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[286] See Case T-56/06 RENV II *French Republic v European Commission*, ECLI:EU:T:2016:228; Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission* ECLI:EU:T:2016:233; and Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227.

[287] See Commission Decision of 7 December 2005 concerning the exemption from excise duty on mineral oils used as fuel for alumina production in Gardanne, in the Shannon region and in Sardinia respectively implemented by France, Ireland and Italy *Official Journal of the European Union* No L 119/12 [2006].

[288] See Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227.

[289] Directive 92/81/EEC *Official Journal of the European Communities* No L 316/16 [1992] repealed by Council Directive 2003/96/EC of 27 October 2003 although article 18 extended the application of reduction to 31 December 2006.

[290] See Council Decision 92/510/EEC of 19 October 1992 authorising Member States to continue to apply to certain mineral oils, when used for specific purposes, existing reduced rates of excise duty or exemptions from excise duty.

[291] See Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission* ECLI:EU:T:2016:233.

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authorised by the Council in 1993.[292] A number of subsequent extensions of the authorisation followed in later years and the last decision concerning the exemption, extended it until 31 December 2006.[293] The French Republic has since 1997 exempted mineral oils used as fuel for the production of alumina in the Gardanne region, from excise duty. The exemption was first authorised by the Council on 30 June 1997[294] and this was extended on a number of occasions until the last extension expired on 31 December 2006.[295]

In May 1998, June 1998 and July 2000, the Commission requested information from the Italian, French and Irish authorities, in order to verify whether the exemption at issue fell within the scope of Articles 87 and 88 of the EC Treaty (now Articles 107 and 108 of the TFEU). The authorities of all member states responded, whereafter the Commission requested them to notify the exemptions as state aid. Their follow-up replies, however, "did not have the status of a notification".[296] Hence, the Commission decided on 30 October that it will initiate a formal investigation procedure provided for in Article 88 (2) of the EC Treaty (now Article 108 (2) of the TFEU) regarding this matter. This was notified to the parties on 5 November 2001 and it was published in the Official Journal on 2 February 2002.[297]

After a prolonged investigation the Commission decided in December 2005 that the tax exemptions granted by France, Italy and Ireland constituted state aid within the meaning of the state aid prohibition in the treaty. France, Ireland and Italy were therefore required to take all necessary measures to recover the state aid granted

[292] See Council Decision 93/697/EC of 13 December 1993 authorising certain Member States to apply or to continue to apply to certain mineral oils, when used for specific purposes, reduced rates of excise duty or exemptions from excise duty *Official Journal of the European Communities* No L 31/29 [1993].
[293] Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission* ECLI:EU:T:2016:233 para 5.
[294] See Council Decision 97/425/EC of 30 June 1997 authorising Member States to apply or to continue to apply to certain mineral oils, when used for specific purposes, existing reduced rates of excise duty or exemptions from excise duty, in accordance with the procedure provided for in Directive 92/81/EEC *Official Journal of the European Communities* No L 182/22 [1997].
[295] See Case T-56/06 RENV II *French Republic v European Commission* ECLI:EU:T:2016:228 paras 3-5.
[296] Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 para 63.
[297] See Commission Decision of 7 December 2005 concerning the exemption from excise duty on mineral oils used as fuel for alumina production in Gardanne, in the Shannon region and in Sardinia respectively implemented by France, Ireland and Italy *Official Journal of the European Union* No L 119/12 [2006]

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from 3 February 2002 onwards, from the recipients.[298] Although the Commission found that the state aid given before this date was incompatible, it did not require recovery of it on the basis of legal principles that are not relevant here.

Several years of complex litigation followed the Commission's decision.[299] On 22 April 2016 the General Court handed down the final judgments and confirmed the Commission's initial decision.[300] Most importantly for present purposes, the Court rejected all the arguments for the contention that the authorisation of the Council precluded the application of the state aid rules to these exemptions. [301]

- The importance of the principle of legal certainty was recognised. This principle aims to ensure that "that situations and legal relationships governed by EU law remain foreseeable" and that "observance of the principle of legal certainty also requires that the institutions avoid, as a matter of principle, inconsistencies that might arise in the implementation of the various provisions of EU law".[302] However, it was accepted that the power of the Council to harmonise excise duty had to be distinguished from the power of the Commission to regulate state aid. The authorisation of the exemption from excise duty therefore did not affect the power of the Commission to apply state aid law.[303]

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[298] Commission Decision of 7 December 2005 concerning the exemption from excise duty on mineral oils used as fuel for alumina production in Gardanne, in the Shannon region and in Sardinia respectively implemented by France, Ireland and Italy *Official Journal of the European Union* No L 119/12 [2006] paras 104-106.

[299] See Joined Cases T-50/06, T-56/06, T-60/06, T-62/06 and T-69/06 *Ireland and Others v Commission of the European Communities* [2007] ECR II-172; Case-89/08 P *Commission of the European Communities v Ireland and Others* [2009] ECR I-11245; *Ireland and Others v European Commission,* Joined Cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV ECLI:EU:T:2012:134; and Case-272/12 P *European Commission v Ireland and Others* ECLI:EU:C:2013:812.

[300] See Case T-56/06 RENV II *French Republic v European Commission* ECLI:EU:T:2016:228; Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233; and Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227.

[301] For the comprehensive reasons for the court's decisions see Case T-56/06 RENV II *French Republic v European Commission* ECLI:EU:T:2016:228; Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233; and Joined Cases T-50/06 RENV II and T-69/06 RENV II, *Ireland and Aughinish Alumina Ltd v European Commission*, ECLI:EU:T:2016:227.

[302] T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 para 63.

[303] Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 para 64-69, see also para 72-73 where it is stated that the Commission may still take these steps even though it was involved in the process of the authorisation by the Council; Case (C-272/12 P *Commission v Ireland and Others* ECR, EU:C:2013:812 para 45-48, 59-74. See also the extension that was given in Council Decision 2001/224/EC of 12 March 2001.

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- It was argued that the Lex Specialis in terms of which the authorisation was given could displace the general state aid rules as they dealt with different powers as explained before. However, it was similarly accepted that the authorisation could not displace the state aid regime as they operated in different spheres.[304]

- It was accepted that the Commission could not be estopped from applying the state aid rules simply because it did not previously take steps to do so or removed any uncertainty as to which of these rules applied. European law did not recognise estoppel although legitimate expectation and legal certainty could be protected in some situations, but these principles were not applicable in this case.[305]

- In certain cases the legitimate expectations of parties would be protected but in this case it would not allow the parties to argue that state aid was illegal. It only protected them from having the state aid reclaimed up to the point where they were disabused of their expectation, that is when the Commission on 2 February 2002 published that it would initiate formal investigation procedures.[306]

These cases make it clear that it may be difficult to determine the scope of state aid rules and the extent to which other rules may limit the scope of state aid rules. These issues will be even more difficult where state aid rules are both enacted and applied by a country rather than a supra-national body. However, the cases illustrate that some general legal rules may be developed to address these difficulties.

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[304] Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 para 78-86. See Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227 para 46.

[305] Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227 para 56. See also para 75-76 on misuse of power.

[306] Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland and Aughinish Alumina Ltd v European Commission* ECLI:EU:T:2016:227 para 50, 205ff; Joined Cases T-60/06 RENV II and T-62/06 RENV II *Italian Republic and Eurallumina SpA v European Commission*, ECLI:EU:T:2016:233 para 76 read with para 161-222. See also on amounts that may be claimed back Case T-56/06 RENV II *French Republic v European Commission* ECLI:EU:T:2016:228. Although the time frames during which the member states granted the tax exemption and the duration of the exemption differ in the relevant member states, the Commission decided that only the aid granted from 3 February 2002 until 31 December 2003 was incompatible with. the internal market. See para 101-103 of Commission Decision of 7 December 2005 concerning the exemption from excise duty on mineral oils used as fuel for alumina production in Gardanne, in the Shannon region and in Sardinia respectively implemented by France, Ireland and Italy *Official Journal of the European Union* No L 119/12 [2006] recital 5 which makes it clear that authorisation would not affect state aid procedures.

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6 Procedural rules relating to the state aid prohibition

6 1 Introduction

In order to ensure that the state aid prohibition is uniformly applied throughout the EU single market and to create transparency and legal certainty[307] certain procedures have been incorporated in the founding treaties, the treaties currently in force and in other regulatory instruments.[308] Member states have to comply with these procedures before state aid can be granted to any undertaking which have an economic activity within its territory. These procedural rules ensure that no undertaking gets an "economic advantage" by receiving state aid.[309]

The procedural rules are set out in Article 108 of the TFEU and the "Procedural Regulation" of 2015.[310] The main feature of the procedural rules is that member states must inform the Commission of any plans to grant aid to an industry, to a particular undertaking or for a certain production line or if the member state wants to alter existing aid.[311] Member states are not allowed to put into effect any aid that needs to be notified before the Commission has taken a decision authorising such aid. This is referred to as the "standstill clause". Even if a state aid measure prima facie seems to be compatible with the internal market, the member state which intends to grant the aid still needs to notify the Commission of the planned aid.[312] Any aid which was granted in breach of the notification requirement is thus unlawful. Even if the Commission declares the state aid compatible afterwards, it is not legitimised through the Commission's declaration of compatibility. In fact, the Commission may issue certain corrective measures for aid awarded before its

[307] See the Preamble of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[308] See the discussion on the Procedural Regulation in para 6.2 of this chapter.
[309] I Simplecean-Stroia "Study of the State Aid Policy in the European Community: The Illegal State Aid Problem" (1997) 3(1) *Journal of International Legal Studies* 87 88.
[310] See Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No L 248/9 [2015].
[311] Article 108(3) of the TFEU.
[312] See Case C-71/04 *Administración del Estado v Xunta de Galicia* [2005] ECR I-7419 para 31.

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declaration of compatibility. These include that the Commission may require the member state to suspend the aid or to recover any unlawful aid.[313]

It is thus important to differentiate between the legality of aid and its compatibility with the internal market.[314] Legality has to do with whether member states have followed the correct procedure, when it decided to implement state aid. If the required procedure was not followed and the aid measure was implemented by the member state without the knowledge and approval of the Commission, such aid was unlawfully implemented and the Commission can make a declaration to this effect. It can request the member state to abolish or alter the aid measures. It may also require the recipient of the aid to return the aid.

In regard to the question of compatibility, the procedural rules in Article 108 of the TFEU are indeed followed by the member state before implementing any planned aid but the Commission has the final say on whether the planned state aid is compatible with the internal market or not. Only the Commission can decide on the compatibility of the aid with the single market. Should the Commission decide that the planned aid is not compatible; the member state has to abandon its plans to implement the aid. All these procedural rules were codified in a procedural regulation which will now be discussed.

6 2 The "Procedural Regulation"

Article 109 of the TFEU enables the Council to make regulations which sets conditions for the application of Article 108, in particular in regard to the requirement that aid must be notified to the Commission. In terms of this article the Council is also permitted to determine certain categories of aid which could be exempted from the notification procedure. As a result, the Council adopted the first "Procedural Regulation" in 1999.[315] It was meant to be a codification of the "consistent practice

[313] Article 13 (1) and (2) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[314] For a general observation in this regard see Case 323/82 *Intermills v the Commission of the European Communities* [1984] ECR-3809 3816.
[315] Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty *Official Journal of the European Communities* No. L 83 [1999].

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for the application of Article 93" (now Article 108), developed by the Commission in accordance with the case-law of the CJEU.[316] As part of the modernization plans for the EU state aid rules and since the "Procedural Regulation" of 1999 had been amended on several occasions, the Council enacted a new "Procedural Regulation" in 2015 which repealed the "Procedural Regulation" of 1999.[317] Hence the Procedural Regulation of 2015 is the focus of this discussion.

The "Procedural Regulation" applies to aid in all sectors even though special procedural regulations are applied in certain sectors.[318] The regulation distinguishes between existing aid and new aid. This is due to the developing nature of the EU state aid policy and also because aid which did not constitute state aid when it was put into effect, may since have become aid within the ambit of the prohibition.[319] It sets out two different processes on how the Commission will deal with new aid on the one hand and how it will deal with existing on the other hand.[320] Existing aid includes firstly, all aid schemes and individual aid that were in place before the treaty entered into force in a number of EU member states, secondly, all aid schemes and individual aid that were authorised either by the Commission or the Council, thirdly, aid that is deemed to be authorised after the Commission failed to act within the two month time-limit after it received a notification from the member state and the member state has proceeded with the implementation of the aid after informing the Commission of its decision to do so and lastly, aid that was initially on its implementation not considered to be state aid but became state aid afterwards due to the evolution of the internal market and the member state has not taken steps to

[316] Preamble Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty *Official Journal of the European Communities* No L 83[1999].
[317] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L248/9 [2015].
[318] Para 2 of the Preamble of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No L 248/9 [2015].
[319] Para 4 of the Preamble of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[320] See Chapter II and VI of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No L 248/9 [2015] respectively.

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alter it.[321] New aid is defined as "all aid, that is to say, aid schemes and individual aid, which is not existing aid, including alterations to existing aid".[322]

In terms of the "Procedural Regulation" a member state must notify the Commission of any plan to give new aid. In the notification the member state must provide all information[323] that is necessary to help the Commission with its preliminary examination[324] into the state aid measure and with its final decision after a formal investigation[325] into the aid measure was initiated. The Commission has two months after receiving a complete notification from a member state to conclude a preliminary examination of the notified aid.[326] All aid that was notified to the Commission shall only be implemented after the Commission has authorised it.[327] In the event that the Commission, after its preliminary examination, find that no doubts are raised as to the compatibility of the notified aid with the internal market, the Commission shall decide that the aid measure is compatible with the internal market.[328] However, should the Commission, based on its preliminary examination, be unable to decide that the planned aid is compatible with the internal market; the Commission will start the formal investigation procedure set out in Article 108(2) of the TFEU.[329] During the formal investigation the Commission will gather all necessary information which will

[321] See Article 1(b) Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[322] Article 1 (c) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No L 248/9 [2015].
[323] Article 2(2) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[324] For more on the preliminary examination see Article 4 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[325] For more on the closing process after a formal investigation see Article 9 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[326] Par.7 of the Preamble of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[327] See Article 3 which is also referred to as the "standstill clause".
[328] Article 4 (3) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No L 248/9 [2015].
[329] Para 8 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification) *Official Journal of the European Union* No. L 248/9 [2015].

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allow it to assess the compatibility of the planned state aid measure.[330] All interested parties[331] are allowed to submit comments during the formal investigation. The member state which planned to provide the aid is not allowed to implement the aid until the Commission has reached a final decision on its compatibility with the internal market.[332] The Commission will only close its formal investigation when it has made a final decision as to the compatibility of the aid measure with the internal market. It can decide firstly, that the notified measure does not constitute aid, secondly, that the aid is compatible with the internal market and thirdly, that the notified aid is not compatible with the internal market.[333] Should the Commission decide that the aid is not compatible with the internal market, it will require the member state not to put the aid into effect.[334]

In regard to existing aid, member states are required to provide the Commission with all necessary information which will enable the Commission to review the exiting aid measure.[335] If the Commission, after having received such information and the review of the aid measure, concludes that it is not or no longer compatible with the internal market, it shall inform the member state concerned of this decision. The member state should be provided with one month to submit its comments on the Commission's decision.[336] If the Commission is still of the view that the existing aid measure is not or no longer compatible with the internal market, it has to make certain proposals to the member state concerned in regard to the aid measure. The

[330] Para 8 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification) *Official Journal of the European Union* No. L 248/9 [2015].
[331] An interested party is defined as "any Member State and any person, undertaking or association of undertakings whose interests might be affected by the granting of aid, in particular the beneficiary of the aid, competing undertakings and trade associations" Article 1 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification) *Official Journal of the European Union* No L 248/9 [2015].
[332] See Article 93 of the EEC Treaty.
[333] Article 9 (1)- (6) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No L 248/9 [2015].
[334] Article 9 (5) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[335] Article 21 (1) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[336] Article 21 (2) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].

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Commission may recommend (i) substantive amendments to the existing aid measure, (ii) to the member state to follow the procedural requirements in the TFEU and the Procedural Regulation or (iii) that the member state abolishes the aid measure.[337] If the member state concerned accepts the Commission's recommendation it will be bound by the acceptance and if not, the Commission may start a formal investigation into the aid measure.[338]

There is no doubt that the codification of the procedural rules created legal certainty in regard to the application of the state aid prohibition. It sets out clearly when, how and under what circumstances member states are obliged to follow the procedural rules and what could happen if member states do not follow the rules. This makes it essentially impossible for member states to argue that they were not aware of particular procedural aspects of the state aid prohibition.

7 The state aid prohibition and its application to Public Undertakings and Services of General Economic Interest

7 1 Public Undertakings

The EU, like other countries, also draws a distinction between public and private undertakings. A public undertaking, the equivalent of an SOE in South Africa, has been defined as "any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it".[339] All other undertakings outside of this definition are private undertakings. Despite this distinction, EU law does not allow for differential treatment of private and public undertakings in regard to competition rules in general and state aid rules in particular. This has been established in EU primary legislation, case law and Commission communications. Koenig and Von Wendland are thus correct when they state that the "supranational

[337] Article 22 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[338] Article 23 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union *Official Journal of the European Union* No. L 248/9 [2015].
[339] Case 118/85 *Commission of the European Communities v Italian Republic* [1987] ECR -2599.

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legal tools" which the Commission can use to spot any hidden advantages given to public undertakings by member states and which could infringe the state aid prohibition are numerous.[340]

- Firstly, Article 106 (1) of the TFEU does not allow differential treatment of public undertakings. It provides that in the case of public undertakings and all undertakings to which member states grant special or exclusive rights, the member states may not enact or maintain in force any measure contrary to the competition and state aid rules contained in Articles 101 to 109. All undertakings which are entrusted with the operation of services of general economic interest and those which have the character of a revenue-producing monopoly are subjected to the competition rules, for as long as the application of the competition rules does not obstruct the performance of the particular tasks assigned to these undertakings.[341]
-Secondly, the EU courts have on numerous occasions[342] confirmed that EU competition rules apply to all undertakings that conduct economic activities, regardless of their ownership.[343] The concept of an undertaking is comprehensively discussed in chapter two above.[344] It suffices to state here that in H*öfner v Macrotron*[345] the CJEU made clear that the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed".[346] And in *Steinike und Weinlig v*

[340] C Koenig & B Von Wendland *The Art of Regulation* (2016) 44.
[341] Article 106 (1) of the TFEU.
[342] See in this regard Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979 para 21; Joined Cases C-159/91 and C-160/91 *Poucet and Fistre v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon* [1993] ECR I-637 para 17; Case C-244/94 *Federation Française des Sociétés d'Assurance v Ministère de l'Agriculture et de la Pêche* [1995] ECR I-4013 para 14; Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751 para 77; Joined Cases C-115/97, C-116/97 and C-117/97 *Brentjens' Handelsonderneming BV v Stichting Bedrijfspensioenfonds voor de Handel in Bouwmaterialen* [1999] ECR I-6025 para 77; and Case C-219/97 *Drijvende Bokken BV v Stichting Pensioenfonds voor de Vervoer- en Havenbedrijven* [1999] ECR I-6121 para 67.
[343] See in this regard in para 1.1 of chapter 2 for the discussion on the term undertaking and the reference to the definition of public undertaking as set out in Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Union* No L318/17 [2006].
[344] See the discussion on the concept of an undertaking in para 1.1 of chapter 2.
[345] Case C-41/90 [1991] ECR I-1979.
[346] *Höfner v Macrotron* [1991] ECR I-1979 para 21.

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Germany[347] the CJEU also confirmed that the treaty provisions on state aid covers all private and public undertakings and all their production.

- Thirdly, the Commission also confirmed this position in its directive on the transparency of financial relations between member states and public undertakings.[348] The Commission recognised that public undertakings play a substantial role in the national economy of the member states and that member states in some situations may grant special or exclusive rights to particular undertakings.[349] It also recognised that these undertakings are often in competition with private undertakings.[350] Therefore the Commission emphasised that the treaty eliminates any unjustified discrimination between public and private undertakings in the application of the rules on competition.[351] The Commission, however points out that the complex nature of financial relations between public authorities and public undertakings may cause difficulties when the Commission has to exercise its supervisory duties to ensure no state aid is awarded which is incompatible with the internal market.[352] Consequently the Commission noted that fair and effective application of the state aid rules to both private and public undertakings alike can only be achieve if the financial relation between public authorities of member states and public undertakings are transparent.[353] Especially since member states are able to exercise influence over public undertakings in various ways such as (i) financial participation or (ii) rules governing the management of the undertaking.[354] The Commission noted that such transparency would ensure that a clear distinction is

[347] Case 78/76 [1977] ECR 595 para 18.
[348] See Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[349] Paras 2-3 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006] .
[350] Para 3 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[351] Para 4 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[352] Para 6 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[353] Para 7 Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[354] Joined cases 188 to 190/80 *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland V Commission* [1982] ECR -2545 2579.

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made between the role of the member state as public authority and its role as a market participant[355] because member states may act by either (i) exercising their public powers or (ii) by carrying on economic activities of an industrial or commercial nature.[356] In order to determine in which capacity the member state is acting, the activities of the member state need to be considered.[357] This distinction is important because the competition and state aid rules will apply as normal if the member state carries on economic activities on a market, while specific rules will apply when it exercises its public powers.

A transparent relation between member states and public undertakings will also ensure that the Commission has knowledge of:

> "(a) public funds made available directly by public authorities to the public undertakings concerned;
> (b) public funds made available by public authorities through the intermediary of public undertakings or financial institutions;
> (c) the use to which these public funds are actually put."[358]

The objective of the directive is to promote the effective application to public undertakings of the state aid provisions contained in Articles 107 and 108 of the TFEU.[359] The directive, together with the state aid provisions of the TFEU and the various judgements of the CJEU, ensures the equal treatment of both public and private undertakings.[360]

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[355] Para 8 of Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[356] Case 118/85 *Commission of the European Communities v Italian Republic* [1987] ECR- 2599 para 7.
[357] Case 118/85 *Commission of the European Communities v Italian Republic* [1987] ECR -2599 para 7.
[358] Article 1 of the Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings *Official Journal of the European Communities* No L 318/17 [2006].
[359] Joined cases 188 to 190/80 *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland V Commission* [1982] ECR -2545 2571.
[360] Joined cases 188 to 190/80 *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland V Commission* [1982] ECR 2545 2571.

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7 2 Services of General Economic Interest (SGEI)

The notion of SGEI has been developed in case law,[361] primary EU legislation[362] and instruments[363] issued by the EU Commission.[364] Nevertheless, no particular definition has been ascribed to the concept. What are SGEI and why do they exist in the EU? The EU Commission states: "Services of general economic interest (SGEI) are economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied (or would be supplied under different conditions) if there were no public intervention."[365] Article 14 of the TFEU provides the clearest reason for the existence of SGEI in the EU where it states that SGEI are rooted in the shared values of the EU and they play a central role in promoting social and territorial cohesion. The article encourages the EU and its member states to take care that SGEI operate on the basis of principles and conditions which enable them to fulfil their missions. In essence SGEI are public services which are entrusted by member states to either private or public undertakings and are "performed for an economic consideration"[366]

Article 1 of Protocol 26 of the TFEU provides member states with a wide discretion to designate a service as a SGEI, "tailored as closely as possible to the needs of the users."[367] Member states may also exercise their discretion to designate a service

[361] See Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* v *Nahverkehrsgesellschaft Altmark* [2003] ECR I-7747; *European Commission v Hungary* (C-171/17) EU:C:2018:881*; BUPA v Commission* [2008] E.C.R. II-8*;* and *Chronopost SA v Union Francaise de l'Express (UFEX)* (C-83/01 P) EU:C:2003:388

[362] See Protocol No. 26; Articles 14 and 36; and Article 106(2) of the TFEU.

[363] Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest *Official Journal of the European Union* (2012/C 8/4); Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3); European Union framework for State aid in the form of public service compensation (2011) *Official Journal of the European Union* (2012/C 8/15); and Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest *Official Journal of the European Union* (2012/L 114/8).

[364] For more on the concept see also MT Karayigit "The notion of Services of General Economic Interest" (2009) 15(4*) European Public Law* 575-595.

[365] https://ec.europa.eu/competition/state_aid/overview/public_services_en.html (accessed on 6 February 2020).

[366] *European Commission v Hungary* (C-171/17) EU:C:2018:881.

[367] *European Commission v Hungary* (C-171/17) EU:C:2018:881 para 28. See also T Muller "Efficiency Control in State Aid and the Power of Member States to Define SGEIs" (2009) 1 *European State Aid Law*

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which is already offered on the market as a SGEI if it can show that "unsatisfactory conditions not consistent with the public interest, as it is defined by the Member State concerned"[368] are present. This discretion gives recognition to the differences in the social position and economic development in each member state. It is further based on the notion that only a member state knows what public services it needs to deliver to its people to ensure social cohesion.[369] It is also this wide discretion that makes an outright definition of SGEI impossible since the concept will certainly be differently implemented in each member state, depending on the needs of its citizens. As a result of the discretion of member states, SGEI exist in a wide variety of areas such as public transport services, postal services[370] and national electricity supply.[371] However, the discretion of the member state is open to challenge if the Commission is of the opinion that the member states wrongly designated a service as a SGEI.[372]

A number of important statements on SGEI by the CJEU in *European Union v Hungary*[373] provide greater clarity on the position which SGEI occupies in the EU.

- Firstly, "services may be considered to be services of general economic interest only if they are provided in application of a special task in the public interest entrusted to the provider by the Member State concerned. This assignment should be made by way of one or more acts, the form of which is determined by the Member State concerned, and should specify the precise nature of the special task." [374]
- Secondly, "[s]ervices of a general economic interest are entrusted with important tasks relating to social and territorial cohesion. The performance of these tasks should not be obstructed…"[375]

Quarterly 39-46 and N Fiedziuk "Towards decentralization of state aid control: the case of services of general economic interest" (2013) 36(3) *World Competition* 387-408.

[368] *European Commission v Hungary* (C-171/17) EU:C:2018:881 paras 56-57.

[369] See in this regard the comments made by M Aleksander "Services of General Economic Interest: Towards Common Values" (2016) 1 *European State Aid Law Quarterly* 28.

[370] *Case C-340/99 TNT Traco v Poste Italiane* [2001] ECR 1-4109 para 53.

[371] Case C-159/94 Commission v France [1997] ECR 1-5815.

[372] M Aleksander "Services of General Economic Interest: Towards Common Values" 2016 1 *European State Aid Law Quarterly* 23 and W Sauter "The Altmark package mark II: new rules for state aid and the compensation of services of general economic interest" 2012 33(7) *European Competition Law Review* 307.

[373] *European Commission v Hungary* (C-171/17) EU:C:2018:881.

[374] *European Commission v Hungary* (C-171/17) EU:C:2018:881 para 70.

[375] *European Commission v Hungary* (C-171/17) EU:C:2018:881 para 72.

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- Lastly, member states have the freedom "to define, in conformity with [EU] law, what they consider to be services of general economic interest, how those services should be organised and financed, in compliance with State aid rules, and which specific obligations they should be subject to."[376] This freedom of the member states is also referenced by the EU Commission in its Communication on the application on the application of the state aid rules to compensation granted for SGEI.[377]

For purposes of this study it is important to determine how and to what extent EU state aid rules apply to SGEI. This is important since providers of SGEI in most instances have public service obligations which can in several respects be compared to those of SOEs in South Africa.

7 2 1 SGEI and the EU state aid rules

The main governing instruments of SGEI for purposes of state aid control are the TFEU[378] and the so-called "SGEI package",[379] referring to the "SGEI Communication",[380] "SGEI Decision",[381] "SGEI Framework"[382] and "SGEI *de minimis* Regulation".[383]

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[376] *European Commission v Hungary* (C-171/17) EU:C:2018:881 para 72.
[377] See Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest *Official Journal of the European Union* C8/4 (2012) para 2.
[378] See Protocol No. 26; Articles 14 and 36; and Article 106(2) of the TFEU.
[379] For more on the "SGEI package" see A Sinnaeve "What's New in SGEI in 2012 - An Overview of the Commission's SGEI Package" (2012) 2 *European State Aid Law Quarterly* 347-367; D Geradin "Public compensation for services of general economic interest: an analysis of the 2011 European Commission framework" (2012) 11(2) *European State Aid Law Quarterly* 51-62; D Geradin "The new SGEI package" 2012 3(1) *Journal of European Competition Law & Practice* 1-3; and W Sauter "The Altmark package mark II: new rules for state aid and the compensation of services of general economic interest" 2012 33(7) *European Competition Law Review* 307-313.
[380] Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest *Official Journal of the European Union* (2012/C 8/4).
[381] Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).
[382] European Union framework for State aid in the form of public service compensation (2011) *Official Journal of the European Union* (2012/C 8/15).
[383] Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest *Official Journal of the European Union* (2012/L 114/8).

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The EU Commission states that:

> "For certain services of general economic interest to operate on the basis of principles and under conditions which enable them to fulfil their missions, financial support from the State may prove necessary to cover some or all of the specific costs resulting from the public service obligations."[384]

SGEI can be provided by both private and public undertakings without requirements for state financing, while other providers will need compensation to deliver SGEI.[385] It is when there is provision of financial support by public authorities in member states to the providers of SGEI, that the state aid rules may become applicable since the compensation may constitute state aid.[386]

With their entrusted mission in mind, a special set of state aid rules apply to SGEI. State aid in this context is treated more leniently than in other situations.[387] This more lenient approach is expressed in Article 106 (2) of the TFEU which provides that:

> "Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union."

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[384] Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3) para 2.

[385] Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest *Official Journal of the European Union* C8/4 (2012) para 2.

[386] For when state aid rules may become applicable to SGEI, see N Phedon "Competition and Services of General Economic Interest in the EU: Reconciling Economics and Law" (2003) 2 *European State Aid Law Quarterly* 183-210.

[387] See Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-7747 and Joined Cases C-34/01 to C-38/01 *Enirisorse SpA v Ministero delle Finanze* [2003] ECR I-14243.

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Furthermore, the lenient application of state aid rules to SGEI endures in a number of other primary sources, including instruments issued by the Commission[388] and the fundamental case of *Altmark Trans and Regierungpräsidium Magdeburg v Nahverkehrsgesellschaft Altmark (Altmark).*[389] These sources place financial support granted to the providers of SGEI outside the scope of the EU state aid rules, if certain criteria are met. In *Altmark* the CJEU dealt comprehensively with the application of state aid rules to public compensation for SGEI and provided clarity on when SGEI enjoy different treatment under the state aid rules. The court stated that for public compensation to escape classification as state aid it must meet the following criteria:

- "First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined."
- "Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings."
- "Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations. Compliance with such a condition is essential to ensure that the recipient undertaking is not given any advantage which distorts or threatens to distort competition by strengthening that undertaking's competitive position."
- "Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would

[388] See Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).); European Union framework for State aid in the form of public service compensation (2011) *Official Journal of the European Union* (2012/C 8/03); Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest *Official Journal of the European Union* 2012/C 8/02; Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest *Official Journal of the European Union* (2012/ L 114/8); and Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest *Official Journal of the European Union* 2012/C 8/02.

[389] Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* v *Nahverkehrsgesellschaft Altmark* [2003] ECR I-7747. For an analysis of this case see E Szyszczak "Altmark assessed" in E Szyszczak (ed) *Research Handbook on European State aid Law* (2011) 293-326.

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allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means…so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations."

If compensation by a public authority falls short of any of the *Altmark* criteria, the compensation falls within the ambit of the state aid rules. The rules will apply in the same way as it would to any other state aid. This includes compliance with all procedural rules of the state aid control system by the public authority of the member state unless it can be absolved from the state aid rules via the "SGEI package" which refer to the legislative instruments issued by the Commission. Overcompensation by the public authorities of member states for SGEI should therefore be avoided since the state aid rules can become applicable for the excess even if it is not applicable to the compensation which covers the cost of fulfilling the public service obligations.[390]

Firstly, the Commission adopted an SGEI-specific *de minimis* Regulation[391] which states that certain compensation measures do not constitute State aid within the meaning of Article 107 of the TFEU. The Commission felt that it was appropriate to introduce this measure, alongside the general de minimis Regulation,[392] as there was a need for specific *de minimis* rules for undertakings providing SGEI.[393] The Regulation provides that any aid granted to undertakings for the provision of a SGEI is deemed not to meet all the criteria of Article 107(1) of the TFEU and is exempted from the notification requirement of Article 108(3) of the TFEU, if the total amount of

[390] Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3) para 16. See also K Van Buiren, M Gerritsen & J Van der Voort "The Prohibition of Overcompensation to Services of General Economic Interest" (2014) 13(1) *European State Aid Law Quarterly* 61-66.

[391] Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest *Official Journal f the European Union* (2012/L 114/8).

[392] See the discussion in para 4.5 of this chapter on general de minimis rule.

[393] See Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest interest *Official Journal of the European Union* (2012/L 114/8) para 3.

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aid does not exceed EUR 500 000 over any period of three fiscal years and the other listed requirements are met.[394]

Secondly, the Commission issued a Decision[395] which sets out the conditions under which public service compensation granted to undertakings entrusted with the operation of SGEI is compatible with the internal market and exempt from the requirement of notification in Article 108(3) of the TFEU.[396] The exemption under the decision will only be applicable if the period of the entrustment of the SGEI does not exceed 10 years[397] and the exemption will only continue if the conditions for the application of the Commission's decision continue to be met.[398] Aid covered by the exemptions includes:

(a) aid which does not exceed an annual amount of EUR 15 million for the provision of SGEI in areas other than transport and transport infrastructure;[399]

(b) aid for SGEI provided by hospitals;

(c) aid for SGEI to meet social needs;

(d) aid for air or maritime links to islands under limited circumstances; and

(e) aid for airports and ports under limited circumstances.[400]

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[394] Article 1 of Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest interest *Official Journal of the European Union* (2012/L 114/8).

[395] Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).

[396] Article 1 of Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).

[397] Article 1 of Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).

[398] Article 3 of Article 1 of Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).

[399] Article 1 of Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).

[400] Article 1 of Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).

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Furthermore, the amount of compensation is not allowed to exceed what is necessary to cover the net cost incurred in discharging the public service obligations, including a reasonable profit, with the Decision providing the method on how to determine the net cost.[401]

Lastly, the principles set out in the EU framework for State aid in the form of public service compensation (2011)[402] apply to public service compensation in so far as it constitutes state aid not covered by the aforementioned Commission Decision or the SGEI-specific *de minimis* Regulation. The framework spells out the conditions under which such state aid can be found compatible with the internal market[403] and applies to public service compensation in the field of air and maritime transport. The framework states that:

> "State aid falling outside the scope of Decision 2012/21/EU may be declared compatible with Article 106(2) of the Treaty if it is necessary for the operation of the service of general economic interest concerned and does not affect the development of trade to such an extent as to be contrary to the interests of the Union."[404]

The special regime regarding SGEI will be further considered in developing the proposal for state aid regulation for South Africa in chapter 5. It shows that there may be good reasons to sometimes leave the consideration of the promotion of public interest to the executive or the politicians and to exclude them from consideration by regulators, it will assist the determination of the types of aid and entities that should be regulated in South Africa, and it will assist regulators in determining public interest even where they have jurisdiction to consider whether certain state aid is proper.

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[401] Article 5 of Commission Decision 2012/21/EU of 21 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest *Official Journal of the European Union* (2012/L 7/3).
[402] European Union framework for State aid in the form of public service compensation *Official Journal of the European Union* 2012/C 8/03 para 2.
[403] European Union Framework for State aid in the form of public service compensation *Official Journal of the European Union* 2012/C 8/03 para 7.
[404] European Union Framework for State aid in the form of public service compensation *Official Journal of the European Union* 2012/C 8/03 para 11.

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8 Enforcement of the EU state aid prohibition

The Commission[405] is the watchdog for competition in the EU. It is responsible for enforcing the EU state aid rules and to ensure the consistent application of the state aid rules. Its members are chosen for a period of five years from among the nationals of the member states on the basis of a system of strictly equal rotation between the member states which reflects the demographic and geographical range of all the member states.[406]

Article 17 of the TEU provides that the Commission shall ensure the application of the various treaties and oversee the application of EU law under the control of the CJEU. The Commission is thus responsible for the "day-to-day application" of EU competition rules. The CJEU pointed out in *Steinike und Weinlig v Germany*[407] that the intention of the EEC Treaty, in providing through Article 93 (now Article 108) for aid to be kept under constant review and supervision by the Commission, is that a finding that aid may be incompatible with the common market, is to be arrived at by means of an appropriate procedure which it is the Commission' s responsibility to set in motion. Any decision by the Commission, however, is subject to review by the CJEU.[408] The Commission is thus the administrative enforcement body of the state aid rules while the CJEU is the judicial arm responsible for overseeing the proper and correct application of the state aid rules.

Since uniform interpretation of the EU treaties is a fundamental principle of the EU, it is expected that certain matters are dealt with only on Union level with limited and regulated participation by national authorities. The EU state aid rules fall within this category. Persistency, consistency, uniformity and absence of political pressure from governments of member states are some of the reasons why the enforcement of EU

[405] See the discussion in para 3.1 of this chapter on the Treaty Establishing a Single Council and a Single Commission of the European Communities (or the Merger Treaty), which established the Commission as it is known today.
[406] Article 17 (3) of the TEU and Article 244 of the TFEU *Official Journal of the European Union* No C 326/164 [2012].
[407] Case 78/76 [1977] ECR 595 para 9.
[408] See Article 17 of the TEU.

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state aid rules have been the responsibility of only the Commission since their enactment by the EEC Treaty.[409]

National courts, however, were given a limited role[410] in interpreting and enforcing state aid rules, since Union citizens may invoke Union law in their national courts. Enforcement of the state aid rules by national courts is referred to as "private enforcement". Competitors of beneficiaries of illegal aid may approach the national courts for relief and the national courts have to refer to the jurisprudence of the CJEU when making decisions on these matters. Therefore, there is no paucity of jurisprudence on the EU state aid rules that emanates from the national courts of member states.

The involvement of national courts is the result of the "direct effect" principle,[411] which has been described as "the possibility of natural or legal persons in Member States being able to rely on Treaty provisions".[412] This ability of Union citizens to invoke Union law in their national courts was described in *Van Gend en Loos v Nederlandse Administratis Der Belastingen*.[413] The CJEU stated that:

> "…the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals. Independently of the legislation of Member States, *Community law therefore not only imposes obligations on individuals but is also intended to confer upon them rights which become part of their legal heritage."*[414]

[409] In this regard see N Fiedzuik "Towards Decentralization of State Aid Control: The Case of Services of General Economic Interest" (2013) 36(3) *World Competition: Law & Economics Review* 387 387-408.
[410] See in this regard V Kreuschitz & N Bermejo "The role of the national courts in the enforcement of the European State Aid Rules in V Tomljenović, N Bodiroga-Vukobrat, VB Malnar & I Kunda *EU Competition and State Aid Rules: Public and Private Enforcement* (2017) 221 221.
[411] *Syndicat français de l'Express international (SFEI) and others v La Poste and others* Case C-39/94 [1996] ECR -3547 para 39.
[412] ML Struys & H Abbott "The role of national courts in state aid litigation" (2003) 28(2) *European Law Review* 172 172.
[413] Case 26/62 (1963) ECR- 95 96.
[414] My emphasis.

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Although national courts cannot make decisions on the compatibility[415] of aid with the internal market, as that is the exclusive competence of the Commission, they do however have a "complementary" role. In *Dimosia Epicheirisi Ilektrismou AE (DEI) v European Commission*[416] the Court of Justice said:

> "It should be noted, first of all, that, in accordance with settled case-law, implementation of the State aid control system is a matter, first, for the Commission and, second, for the national courts, each of which fulfil complementary and separate roles"

National courts protect the rights of individuals (natural and corporate individuals) who may be affected when a member state has given aid that is possibly in breach of the procedural rules of Article 108 of the TFEU, until the Commission has had an opportunity to make a final decision regarding the compatibility of such aid with the internal market.[417]

Steinike & Weinlig v Federal Republic of Germany (Steinike & Weinlig)[418] was one of the first cases to shed light on the competence of national courts to apply Article 107 of the TFEU (at the time Article 92 of the EEC Treaty). The CJEU considered the competence of national courts to invoke the state aid rules in the national legal system whether at the behest of a private party or by its "own motion".[419] The court stated that despite certain limitations, national courts can be called upon to interpret the provisions of Article 107. The court further stated that proceedings which require a national court to interpret the state aid rules in order to determine whether state aid

[415] Only the Commission is competent to do so. The Commission decisions though, may be reviewed by the CJEU. See *Syndicat français de l'Express international (SFEI) and others v La Poste and others* Case C-39/94 [1996] ECR 3547 para 49; *Dimosia Epicheirisi Ilektrismou AE (DEI) v European Commission* [2016] ECLI-797 para 95.
[416] Case C-590/14 *P Dimosia Epicheirisi Ilektrismou AE (DEI) v European Commission* [2016] ECLI-797 para 95.
[417] Case C-590/14 *P Dimosia Epicheirisi Ilektrismou AE (DEI) v European Commission* [2016] ECLI-797 para 95; Case C-354/90 *Fédération Nationale du Commerce Extérieur des Produits Alimentaires and Others v France* [1991] ECR I-5505 para 14; and C-275/10 *Residex Capital IV CV v Gemeente Rotterdam* [2011] ECLI-3544 para 27.
[418] Case 78-76 [1977] ECR 595 para 14.
[419] Para 5.

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was introduced without observance of the preliminary examination procedure provided for in the treaty, may be commenced before national courts.[420]

Since *Steinike & Weinlig* many other cases have dealt with the competence of national courts with regard to the state aid rules. In *Syndicat français de l'Express international (SFEI) and others v La Poste and others*[421] the court stated that national courts must ensure individuals that any infringement of the procedural rules of Article 93 (3) of the EEC Treaty (now Article 108 (3) of the TFEU) by a member states will result in actions being taken by the national courts. In *Kirsammer-Hack v Sidal*[422] the CJEU again emphasised the important role which national courts can play in the enforcement of the state aid rules. The court said that even though the implementation and enforcement of Union state aid rules is a matter for the Commission, the Commission's powers in regard to the state aid rules do not preclude individuals from bringing proceedings before a national court in order to determine whether a state measure which was not notified should have been notified in accordance with Article 93(3) of the EEC Treaty (now Article 108 (3) of the TFEU). In *Fédération nationale du commerce extérieur des produits alimentaires and Syndicat national des négociants et transformateurs de saumon v France*[423] the CJEU stated that national courts must offer to individuals, who may have been affected by a breach of the procedural requirements of the state aid rules, a prospect that all the necessary inferences will be drawn, in accordance with their national law, as regards the validity of the state aid measures, the recovery of financial support granted in disregard of the procedural requirements and possible interim measures.[424]

[420] *Steinike und Weinlig v Germany* Case 78/76 [1977] ECR 595 para 9. See also *Fédération Nationale du Commerce Extérieur des Produits Alimentaires and Syndicat National des Négociants et Transformateurs de Saumon v French Republic* [1991] ECR I-5505 paras 9-10.
[421] Case C-39/94 [1996] ECR 3547 para 49.
[422] Case C-189/91 [1993] ECR I-6185 para 14.
[423] Case C-354/90 [1991] ECR 1-5505.
[424] Case C-354/90 *Fédération nationale du commerce extérieur des produits alimentaires and Syndicat national des négociants et transformateurs de saumon v France* [1991] ECR 1-5505 para 12.

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The Commission also made its intention of greater cooperation with national courts in state aid matters known through its first notice on the matter in 1995.[425] The purpose of the notice was to offer guidance on cooperation between national courts and the Commission in state aid matters. The notice also "introduced mechanisms for cooperation and exchange of information between the Commission and national courts."[426] The Commission noted that there were frequent concerns that its final decision in state aid matters are reached long after the distortion of competition has caused injury to third parties.[427] The Commission also recognised that it was not always in the position to act promptly to protect the interest of third parties.[428] It therefore recognised that national courts are better placed to ensure that infringement of the procedural aspect of the state aid rules are dealt with and remedied.[429] The Commission noted that while it must examine all aid measures which fall under Article 107 (1)[430] in order to assess their compatibility with the internal market, national courts must ensure that member states comply with their procedural obligations.[431] It made clear that national courts must safeguard the rights which individuals enjoy as a result of the direct effect of the "standstill clause" in Article 108 (3).[432] It advised that national courts should use all appropriate devices and remedies and apply all relevant provisions of national law to give effect to the direct effect of the "standstill clause".[433] The advantages listed by the Commission for individuals if national courts were more involved in state aid measures include:

(i) that claims for damages as a result of a breach of the "standstill clause" may be brought before national courts since the Commission cannot award damages;

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[425] Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* No C 312/07 [1995].
[426] Para 2 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[427] Para 3 of Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* No C 312/07 [1995].
[428] Para 3 of Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* No C 312/07 [1995].
[429] Para 3 of Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* No C 312/07 [1995].
[430] It was still Article 92 (1) when the Notice was issued.
[431] Para 4 of Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* C 312/07 [1995].
[432] Para 10 of Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* C 312/07 [1995].
[433] Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* C 312/07 [1995] para10.

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(ii) that courts may grant interim relief, for example by ordering the freezing or return of monies illegally paid and may be able to order termination of infringements of the state aid rules more quickly;
(iii) that a claim under Union law and one under national law may be combined, which is impossible with a matter before the Commission; and
(iv) that national courts may award costs to the successful party while this is not the case with a matter before the Commission.[434]

The crucial role which national courts could play in the enforcement of EU state aid was also emphasised by the CJEU in *Andrea Francovich et al. v Italy* when it said:

> "The full effectiveness of Community rules [now Union rules] would be impaired and the protection of the rights which they grant would be weakened if individuals were unable to obtain redress when their rights are infringed by a breach of Community law for which a Member State can be held responsible."[435]

In 2005 the Commission adopted the SAAP, a road map for significant State aid reform.[436] A central objective of the SAAP is to get member states to reduce the aid measures they grant but to instead redirect aid resources to "common interest objectives". The competence of national courts in regard to the state aid rules formed a crucial part of the SAAP. The SAAP also envisaged a further role for national courts whereby they would be determining whether state aid measures fall within a block exemption or under the de minimis rule and are exempted from the notification procedure.[437] The SAAP states that Article 108 has direct effect in member states and it entitles the national courts to either suspend or provisionally order recovery of aid which was awarded before the Commission has approved it.[438] It also states that private litigation on state aid before national courts may increase discipline in the field of state aid. In terms of the SAAP the Commission wants national courts to

[434] Notice on cooperation between national courts and the Commission in the State aid field *Official Journal of the European Communities* C 312/07 [1995] para 13.
[435] Joined Cases C-6/90 and C-9/90 *Andrea Francovich v Italy* [1991] ECR 1-5357 para 33.
[436] See the reference to the SAAP in para 2 of this chapter.
[437] State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005) 107 final para 56.
[438] State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005) 107 final para 55.

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focus on the protection of rights of all interested parties such as competitors of those who received unlawful aid and the enforcement of negative decisions[439] where aid needs to be recovered.[440]

As a result of the state aid reform by the SAAP, the Commission replaced its cooperation notice which was issued in 1995.[441] The aims of the previous cooperation notice are now being pursued by a new Commission Notice of 2009 and the national courts have been given a significant role in enforcing the state aid rules.[442] Firstly, it is settled that the national courts have the powers to interpret the notion of state aid,[443] since the Commission is of the view that case law, Commission guidance and decision making practice provide valuable assistance to national courts and potential claimants for this purpose.[444] And if national courts are unsure whether a measure constitutes state aid, they may ask for a Commission opinion to assist them.[445] Secondly, when proceedings in a national court are dealing with the applicability of the BER[446] or an existing or approved aid scheme, the national court may assess whether all the conditions of the BER or the scheme are met.[447] The national court may ask the Commission for an opinion if it has doubts concerning the applicability of a Block Exemption Regulation or an existing or approved aid scheme.[448] Thirdly, national courts may be asked to intervene where a member state has granted aid without respecting the standstill obligation.[449] Such intervention will protect the rights of individuals affected by the unlawful implementation of the aid.[450] Affected individuals are in most instances the competitors of the beneficiaries of

[439] This refers to decisions in which the Commission decides that aid is not compatible with the internal market.
[440] State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM (2005) 107 final para 55.
[441] See Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[442] Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[443] Para 10 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[444] Para 12 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[445] Para 13 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[446] See the discussion on the BER in para 5.1 of this chapter.
[447] Para 16 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[448] Para 18 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[449] See the discussion on this in para 6 of this chapter.
[450] Para 21(a) of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].

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state aid and the Commission views the protection of their rights as one of the most important roles of national courts in the enforcement of state air rules.[451] Hence, the Commission is of the view that national courts are the perfect forum to get redress for competitors and other third parties affected by unlawful state aid, especially since a number of remedies are available to the affected parties in the national courts. These remedies are (i) preventing the payment of unlawful aid; (ii) recovery of unlawful aid (regardless of compatibility); (iii) recovery of illegality interest; (iv) damages for competitors and other third parties; and (v) interim measures against unlawful aid.[452] Lastly, national courts also play an important role in the enforcement of recovery decisions made by the Commission when the member state fails to implement the Commission's recovery order.[453]

It is submitted that greater involvement of the national courts in the enforcement of the state aid rules, is a welcome development of state aid reform. It is further submitted that greater involvement of the national courts will not only assist the Commission in its enforcement of the state aid rules, but those injured[454] may receive expedient and prompt relief.

9 The position on state aid control outside of the EU: the case of the United States of America and the World Trade Organization (WTO)

The EU state aid rules are arguably the world's only comprehensive state aid control regime. The EU has been described as the only "public authority" in the world which has a state aid control regime forming part of its broader competition policy.[455] Bartosch states that the EU state aid control regime can be found "nowhere else on this planet."[456] Accordingly a full international comparison is not possible.[457] Two

[451] Para 24 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[452] Para 26 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[453] Para 63 of Commission notice on the enforcement of State aid law by national courts *Official Journal of the European Union* No C 85/1 [2009].
[454] See in this regard for example F Pastor-Merchante *About The Role of Competitors in the Enforcement of State Aid Law* 1 ed (2017).
[455] RC Musetescu "The Economics of State Aid Control in the European Union during the Financial Crisis: the Challenge for a Post-Crisis Rhetoric" (2012) 6 *Theoretical and Applied Economics* 175 179.
[456] A Bartosch "State Aid Control in Europe and elsewhere" (2006) 5(1) *European State Aid Law Quarterly* 1 1.

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legal phenomena that have some of the traits of the European state aid regime nevertheless can be described briefly namely:

- the US commerce clause; and
- the WTO subsidy regime..

This study does not intend to provide a full analysis of these aspects but a concise description is provided to show the uniqueness of the EU state aid regime.

9 1 The US Commerce Clause[458]

9 1 1 What does the Commerce Clause regulate?

Ganoulis and Martin observes that the general prohibition of state aid by the TFEU treaty stands in stark contrast to the absence of controls over subsidies or other aid granted by the individual States in the United States.[459] Subsidies and tax exemptions to corporations by individual States and even the United States federal government, however, are not unknown concepts.[460] This is for instance illustrated by cases such as *DaimlerChrysler Corporation v Charlotte Cuno* (*DaimlerChrysler* case)[461] and *Bacchus Imports Ltd v Dias*.[462]

The United States has a "Commerce Clause" as part of its Constitution[463] which protects interstate commerce and competition. The "Commerce Clause" authorises Congress "to regulate Commerce with foreign Nations, and among the several

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[457] Some aspects of state aid in regional economic communities in Africa will be discussed in chapter 5.

[458] The Commerce Clause is also referred to as the "dormant Commerce Clause"; even though the Commerce Clause contains a "positive grant of powers to Congress", the US Supreme Court has also interpreted the language of the Commerce Clause to contain a "negative command", which prohibits "certain state taxation even when Congress has failed to legislate on the subject." See *Oklahoma Tax Commission v Jefferson Lines Inc.* 514 U.S. 175 (1995) 178. See also *Quill Corp. v North Dakota* 504 U.S. 298 (1992); *Northwestern States Portland Cement Co. v Minnesota* 358 U.S. 450 (1959); and *HP Hood & Sons Inc. v Du Mond* 336 U.S. 525 (1949).

[459] I Ganoulis & R Martin "State Aid Control in the European Union: Rationale, Stylised Facts and Determining Factors" (2001) 36(6) *Intereconomics* 289 289.

[460] See DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 3.

[461] 547 U.S. 332 (2006).

[462] 468 U.S. 263 (1984).
In this case certain alcoholic drinks such as okolehao and fruit wine were provided special tax exemptions from Hawaii's liquor tax. This benefit however was not awarded to other locally made alcoholic drinks and the tax had to be paid. Those wholesalers were challenging the liquor tax as unconstitutional and against the Commerce Clause. The Supreme Court invalidated the exemption and found that it was against the Commerce Clause.

[463] Art. I Section 8 clause 3 of the United States Constitution.

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States, and with the Indian Tribes".[464] Not only does the "Commerce Clause" provide Congress with the power to regulate interstate commerce but States are also limited when it comes to discrimination against interstate commerce through the use of State regulations.[465] It is thus established law that the Commerce Clause "has a negative aspect that denies the States the power to unjustifiably discriminate against or burden the interstate flow of articles of commerce."[466] The very nature of the Commerce Clause has been summarized as follows:

> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality."[467]

In *New Energy Company of Indiana v Limbach*[468] the Supreme Court stated that "the Commerce Clause prohibits economic protectionism, that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors."

The Commerce Clause thus prohibits those "chief evils" which may impact on interstate trade and competition. Any actions by a federal State to protect its residents are not outright prohibited though, but it has to be within the confines of the Commerce Clause.[469]

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[464] U.S. Constitution Article I Section 8 Clause 3.
[465] *New Energy Company of Indiana v Limbach* 486 U.S. 269 (1988) 273.
See also *Oregon Waste Systems Inc. v Department of Environmental Quality of State of Oregon* 511 U.S. 93 (1994) 83.
[466] *Oregon Waste Systems Inc. v Department of Environmental Quality of State of Oregon* 511 U.S. 93 (1994) 98.
[467] *HP Hood & Sons Inc. v Du Mond* 336 U.S. 525 (1949) 539.
[468] 486 U.S. 269 (1988) 273.
[469] See in this regard *Oregon Waste Systems Inc. v Department of Environmental Quality of State of Oregon* 511 U.S. 93 (1994) 99 where the US Supreme Court stated that "…nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless "the burden imposed on such commerce is clearly

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In the abovementioned *DaimlerChrysler* case, for example, both the city of Toledo and the State of Ohio offered municipal tax exemptions and state franchise tax credits to DaimlerChrysler Corporation, which at the time manufactured Jeeps. The purpose of the tax benefits was to encourage DaimlerChrysler to expand its operations in the city of Toledo. Local and state taxpayers challenged the offered tax benefits on the basis that it violated the "Commerce Clause" of the Constitution of the United States. The complainants claimed that the tax breaks depleted the State and the local treasuries to which they contributed and "diminishes the total funds available for lawful uses and imposes disproportionate burdens on them". The District Court found that neither of the tax benefits violated the "Commerce Clause", while a Court of Appeals found that only the state franchise tax credit violated the Commerce Clause. The matter was brought to the United States Supreme Court since DaimlerChrysler wanted a review of the invalidation of the franchise tax credit and the complainants sought to review the upholding of the property tax exemption. Even though the Supreme Court dismissed the complainants' challenge on the basis that they did not have standing,[470] it still made observations as to "policy decisions concerning state spending". The court stated that it is unclear whether the tax breaks complained of in the case do in fact deplete the treasury since the aim of those tax benefits was to "spur economic activity" which then may lead to increases in government revenue.[471] The court made reference to one of its classic statements made in 1938: "but the interest of a taxpayer in the moneys of the federal treasury furnishes no basis for an appeal to the preventive powers of a court of equity."[472] It

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excessive in relation to the putative local benefits."" See also DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 3.

[470] Article III of the Constitution of the United States determines when a person has standing to bring a matter before a federal court. The court states that there are many instances in which the court "has denied *federal* taxpayers standing under Article III to object to a particular expenditure of federal funds simply because they are taxpayers unless the taxpayer complies with the three elements laid down in *Lujan v Defenders of Wildlife* 504 U.S. 555 (1992) 560–561 which are (i) the plaintiff must have suffered an "injury in fact"—an invasion of a legally protected interest which is concrete and particularized, (ii) there must be a causal connection between the injury and the conduct complained of—the injury has to be "fairly ... trace[able] to the challenged action of the defendant, and not ... th[e] result [of] the independent action of some third party not before the court; and (iii) it must be "likely," as opposed to merely "speculative," that the injury will be "redressed by a favorable decision.

[471] *DaimlerChrysler Corporation v Cuno* 547 U.S. 332 (2006) 344.

[472] *Alabama Power Co. v Ickes* 302 U.S. 464 (1938) 477.
See also *Commonwealth of Massachusetts v Mellon* 262 U.S. 447 (1923) 601 in which the Supreme Court stated that a taxpayer's "interest in the moneys of the treasury—partly realized from taxation and partly from other

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also noted that state policymakers, as is the case with federal policymakers, has wide discretions to make policy decision on state spending.[473]

Despite the recognition of the State's abilities to make policy decision on state spending, any State regulatory measures on interstate commerce which discriminate against interstate commerce and which create "an economic barrier against competition" will probably be invalidated as violating the Commerce Clause, unless the State can show that the discrimination is justifiable by a "valid factor unrelated to economic protectionism".[474] US citizens have the right to have access to the markets in other federal States on "equal terms" to inhabitants of the state.[475] US federal states therefore may not make rules or regulations which provide home enterprises with a "competitive advantage" over those operating outside of their borders. Any such "differential treatment" between home enterprises and those from outside the border of the State, will likely be in conflict with the Commerce Clause. No State should thus have regulations on interstate commerce in place which aim is "economic protectionism".[476] Therefore, if any federal State regulation causes discrimination against enterprises outside its border it may be viewed as being against interstate commerce and could be challenged.[477]

9 1 2 How does the Commerce Clause compare with EU state aid control?

Schenk argues that the purpose of EU state aid control and the Commerce Clause is not so different.[478] This is because the state aid prohibition in the EU promotes market integration by establishing a level playing field between undertakings and prevents member states from distorting competition, while the Commerce Clause ensures that the individual States do not disrupt or burden interstate commerce in a

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sources—is shared with millions of others, is comparatively minute and indeterminable, and the effect upon future taxation, of any payment out of the funds, so remote, fluctuating and uncertain, that no basis is afforded for an appeal to the preventive powers of a court of equity."

[473] *DaimlerChrysler Corporation v Cuno* 547 U.S. 332 (2006) 346.

[474] *New Energy Co. of Indiana v Limbach* 486 U.S. 269 (1988) 274.

[475] *Granholm v Heald* 544 U.S. 460 (2005) 473.

[476] *C & A Carbone Inc. v Town of Clarkstown* N.Y. 511 U.S. 383 (1994) 390.

[477] *Granholm v Heald* 544 U.S. 460 (2005) 467.

[478] DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 8.

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discriminatory manner.[479] Hence, some parallels can be drawn between EU state aid control and the Commerce Clause in the US.

Firstly, actions by federal States through state legislation may impact on interstate commerce and hurt "out-of-state" competitors by creating barriers to interstate trade. Labelled "one of the chief evils", state tariffs and laws may affect interstate commerce and "out-of- state" competitors[480] just as much as state aid by a member state of the EU may affect trade and competition in the EU, as it may give its residents, corporate or natural, "an advantage" in the marketplace. Both the US Commerce Clause and EU state aid control thus want to protect trade and competitors. Trade here means interstate trade in the US and trade between member states in the internal market in the EU.

Secondly, these systems have well established rules on the validity or lawfulness of a discriminatory state regulatory measure and a state aid measure respectively. In the US, the Supreme Court has established such rules over years. In terms of settled law the courts have to inquire (1) whether the challenged statute regulates "evenhandedly" with only "incidental" effects on interstate commerce, or discriminates against interstate commerce either on its face or in practical effect; (2) whether the statute serves a legitimate local purpose; and, if so, (3) whether alternative means could promote this local purpose as well, without discriminating against interstate commerce.[481] The burden to show that the state's regulatory measure is discriminatory rests on the party who is challenging it but when discrimination is established the burden shifts to the state. Then the state must justify the "local benefits" under the regulatory measure.[482] In this regard the Supreme Court has stated that when the purpose of a state's regulatory measure has to be determined, no special attention will be given to the name, description and characterization which was given to the regulatory measure by the state but the focus instead will be on the "impact of the law".[483]

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[479] DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 8.
[480] See *Comptroller of Treasury of Maryland v Wynne* U.S.135 S. Ct. 1787 (2015) 1794.
[481] *Hughes v Oklahoma* 441 U.S. 322 (1979) 336.
[482] *Hughes v Oklahoma* 441 U.S. 322 (1979) 336.
[483] *Hughes v Oklahoma* 441 U.S. 322 (1979) 336.

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The Supreme Court has over time also established two principles to assist with the determination on the validity of a federal State's regulatory measures. The "virtually *per se* rule of invalidity" invalidates any discriminatory regulatory measures implemented by a federal State unless the State can "show that it advances a legitimate local purpose that cannot be adequately served by reasonable non-discriminatory alternatives."[484] Hence any laws of federal States which treat "out-of-state" and "in-state" economic activities differently may be declared invalid as Justice Blackmun stated in *Maine v Taylor*:[485]

> "Shielding in-state industries from out-of-state competition is almost never a legitimate local purpose, and state laws that amount to "simple economic protectionism" consequently have been subject to a "virtually *per se* rule of invalidity."[486]

Then there is the "balancing test", which was established in *Pike v Bruce Church Inc*:[487]

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[488]

The "balancing test" therefore ensures a balance between the legitimate goals of the federal state's regulatory measures and any burden it may impose on interstate commerce.

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[484] *Oregon Waste Systems Inc. v Department of Environmental Quality of State of Oregon* 511 U.S. 93 (1994) 100–101.
[485] 477 U.S. 131 (1986).
[486] *Maine v Taylor* 477 U.S. 131 (1986) 148.
[487] 397 U.S. 137 (1970).
[488] *Pike v Bruce Church Inc.* 397 U.S. 137 (1970).

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In the EU the position on state aid granted in contravention of Article 107 of the EU treaty is simple and straightforward. This is clearly because of the EU's comprehensive legal framework. The EU regime has been comprehensively discussed above in this chapter.[489] It suffices to state here that the state aid is unlawful for as long as it has not been notified and consented to by the Commission and it will lead to certain actions by the Commission.[490] Even if the Commission declares the state aid compatible with the internal market the Commission's decision does not make the aid lawful.[491]

It is however submitted, that even with the well-established judicial rules in place the comparison that can be drawn with EU state aid control is limited especially because of the absence of a legislative framework established by Congress (the Constitutional Commerce Clause allows Congress to legislate on interstate commerce).[492] It remains within the discretion of the courts whether a state regulatory measure which discriminates against "out-of-state" economic activities is invalid or not. Schenk, for example, argues that the restrictions imposed by the commerce clause are not straightforward.[493] Hence federal States can only be guided by judicial precedent and jurisprudence on the Commerce Clause to make sure that their regulatory measures on interstate commerce are not against the spirit of the Commerce Clause. It is however unlikely that a State will first start researching the jurisprudence on the Commerce Clause to avoid any legal challenge before it implements or executes regulatory measures which may impact on interstate commerce. It is submitted that such a situation would be against the spirit of the principle on federalism[494] which clearly allows individual States to implement

[489] See the discussion in para 6 of this chapter for the action which the Commission may take in regard to unlawful state aid.
[490] See the discussion in para 6 of this chapter for the action which the Commission may take in regard to unlawful state aid.
[491] See the discussion in para 6 of this chapter.
[492] See Article I Section 8 clause 3 of the United States Constitution. See also DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 8.
[493] DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 3.
[494] The United States Constitution provides that: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." See US Constitution Amendment 10. And in *National Federation of Independent Business v Sebelius* 567 U.S. 519 (2012) 533 533 the US Supreme Court stated: "In our federal system, the National Government possesses only limited powers; the States and the people retain the remainder."

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regulatory measures which they view as being to the benefit of the people of the state. It is further submitted that States do not necessarily first decide on the regulatory measures' compatibility with the Commerce Clause before implementing it. It is only when the state regulatory measures which may discriminate between "out-of-state" and "in-state" economic activities are being challenged on the basis that they breach the Commerce Clause, that the protection granted to interstate commerce by the Commerce Clause is triggered. There is however no guarantee that a court will decide against a state's regulatory measures even if there is some level of discrimination between "out-of-state" and "in-state" economic activities[495] for as long as the State can show that the discrimination is justified by a "valid factor unrelated to economic protectionism".[496]

Thirdly, like in the EU, there is also a market-participant doctrine[497] which a federal state could use in its defence against a challenge under the Commerce Clause. The market-participant doctrine differentiates between a State's acts in its governmental capacity and as a market participant. Only when a State acts in its governmental capacity, for example through "burdensome regulation", do its actions become subjected to the Commerce Clause. In the words of the Supreme Court, the Commerce Clause was not only meant to authorise Congress to enact laws which protect and encourage commerce among the States, but it was also meant to create a trade environment free from interference by the States.[498] Even though the States maintain wide powers to legislate for the benefit of their citizens, the Commerce Clause places a limitation upon the power of the States. Therefore a federal state may use the doctrine only if any of its policies are challenged under the Commerce Clause and while implementing and executing the policies it acted as a market-participant and not as a sovereign.

In the EU, however, member states do not have to act as market participants in order to use the MEIP (when a member state act as a market participant, EU

[495] See in this regard the case of *DaimlerChrysler Corporation v Cuno* 547 U.S. 332 (2006) which is discussed in this paragraph.
[496] *New Energy Company of Indiana v Limbach* 486 U.S. 269 (1988) 274.
[497] For more on the market-participant doctrine see *New Energy Co. of Indiana v Limbach* 486 U.S. 269 (1988) 277.
[498] *Freeman v Hewit* 329 U.S. 249 (1946) 252.

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competition rules will in any event apply as it would under normal market circumstances). Member states can use the MEIP as a defence when they have granted state aid which is challenged, even while they act as a sovereign. This differentiates the MEIP from the market-participant doctrine in the US. The member state should only be able to prove that a private investor would have invested in the undertaking to which it granted the state aid in the exact same way as it did.[499] If the member state is successful with using the MEIP as a defence, the state aid will not be viewed as being in contravention of the state aid prohibition.[500]

In conclusion a number of observations can be made in regard to the Commerce Clause and EU state aid control.

Firstly, in essence the Commerce Clause achieves in the United States what the state aid rules achieve in the EU, namely undistorted competition and uninterrupted interstate commerce.

Secondly, just as an EU without state aid control rules might have led to "economic protectionism" by member states towards their own undertakings, a US without the Commerce Clause might also have seen uncontrollable "economic protectionism" by federal States of their economies. "Economic protectionism" in the case of the EU might have led to unlimited state aid by member states while "economic protectionism" in the US might have led to discrimination against out-of-state enterprises, products or services by a federal State through the use of State regulations.

Thirdly, although there are some parallels that can be drawn between EU state aid control and the US Commerce Clause, there will always be a divergence between the US and EU in this area of law. The US, as pointed out by Schenk,[501] rarely provides financial assistance to undertakings. State financial assistance provided to undertakings, is usually in the form of tax exemption by the federal state and the states are allowed in terms of the principle of federalism to act in the best interest of their inhabitants.

[499] See para 4. 4 of this chapter for a discussion on the MEIP in the EU.
[500] See the discussion in para 4.4 of this chapter.
[501] See note 1 in DH Schenk "The Cuno Case: a Comparison of U.S. Subsidies and European State Aid" (2006) 1 *European State Aid Law Quarterly* 3 8.

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Lastly, even though the Commerce Clause could be viewed as the US's equivalent of the EU's state aid rules, it has to be kept in mind though that the state aid rules in the EU operate on a supranational level and apply within twenty eight nation states, while the US is one nation state with constituent federal states that are given some sovereign powers in terms of the constitution.

9 2 WTO subsidy control system

9 2 1 The WTO Agreement on Subsidies and Countervailing Measures

The WTO regulates international trade. It is the only other institution that maintains a subsidy control system which is in some limited respects comparable to the EU state aid rules. This study does not intent to do a detailed analysis of the WTO, its purpose and how it functions. It will, however, only focus on its subsidy control system in so far as it shows parallels with the EU state aid control system.[502] For this purpose, a short and concise summary will be provided on how the WTO came into being.[503]

The WTO subsidy control system has its roots in the General Agreement on Tariff and Trade Treaty of 1947 (GATT).[504] The GATT, once described as "the principal international mechanism for the regulation of international trade",[505] is the predecessor of the WTO. After World War II, the United States was at the forefront of a drive to form an international trade organization. A draft trade agreement was negotiated between twenty three countries, however ultimately only eight countries signed the initial GATT agreement, and the United States was one of these

[502] A comprehensive and thorough comparison of the WTO subsidy regime and the EC state aid control regime has been written by L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009). For more comparison of the WTO subsidy system and the EU state aid control regime see L Rubini "The International Context of EC State Aid Law and Policy: The Regulation of Subsidies in the WTO" in A Biondi, P Eeckhout & J Flynn (eds) *The Law of State Aid in the European Union* (2003) 149 149. See also See T Jaeger "Distinguishing state and private subsidies: a closer look at the state character test" in J Drexl & V Bagnoli *State-initiated Restraints of Competition* (2015) 296 297.

[503] The WTO subsidy rules are also relevant to regional regulation of state aid. See in this regard the discussion on the regional economic communities in Africa in para 2.2.1 of chapter 5.

[504] See JH Jackson *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (2000) 94. For further reading on the GATT and Subsidies see also C-H Nam "Export-Promoting Subsidies, Countervailing Threats, and the General Agreement on Tariffs and Trade" (1987) 1(4) *The World Bank Economic Review* 727 727-743.

[505] PM Kelly & JM Melton "The General Agreement on Tariffs and Trade" (1990) 25(2) *Texas International Law Journal* 317 317.

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countries.[506] Kelly and Melton state that the GATT was meant to be a multilateral agreement which "reciprocally reduce tariffs"[507] for trade between the contracting parties of the GATT. It however evolved to include trade in services, foreign direct investment and intellectual property rights.[508] The contracting parties held regular rounds of negotiation sessions to "discuss trade problems and disputes concerning the interpretation and implementation of the GATT rules."[509]

The GATT already contained controls over the use of subsidies in international trade.[510] In terms of Article XVI of the GATT, contracting parties were required to notify each other of any subsidies that could increase exports from or reduce imports of products to its territory.[511] The contracting party who provided the subsidies were supposed to provide information on the extent and nature of the subsidization, the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from a contracting party's territory and the circumstances which made the subsidization necessary.[512] In the event that the subsidization would have caused a serious threat to the interest of the other parties, the contracting party who provided the subsidies had to discuss with the other contracting parties the possibilities of limiting the subsidization.[513] In order to counter subsidies by contracting parties, Article VI (3) of the GATT allowed for countervailing duties to be levied for the purpose of offsetting any subsidy granted directly or indirectly for the manufacturing, production or export of any products

By the time of the Tokyo Rounds of negotiations between the contracting parties a quest for greater control of subsidies in international trade was led by the United

[506] "General Agreement on Tariffs and Trade" (1989) 14(1) *North Carolina Journal of International Law and Commercial Regulation* iv.
[507] PM Kelly & JM Melton "The General Agreement on Tariffs and Trade" (1990) 25(2) *Texas International Law Journal* 317 317.
[508] C Reitz "Enforcement of the General Agreement on Tariffs and Trade" (1996) 17(2) *University of Pennsylvania Journal of International Economic Law* 555 556- 557.
[509] PM Kelly & JM Melton "The General Agreement on Tariffs and Trade" (1990) 25(2) *Texas International Law Journal* 317 317.
[510] See Article XVI of the General Agreement on Tariffs and Trade of 1947. See also JH Jackson *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (2000) 94.
[511] See Article XVI of the General Agreement on Tariffs and Trade of 1947. See also C-D Ehlermann & M Goyette "The Interface between EU State Aid Control and the WTO Disciplines on Subsidies" (2006) 4 *European State Aid Law Quarterly* 695 695.
[512] See Article XVI of the General Agreement on Tariffs and Trade of 1947.
[513] See Article XVI of the General Agreement on Tariffs and Trade of 1947.

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States.[514] Subsequent to the Tokyo Rounds the contracting parties implemented stricter rules for export subsidies.[515] These rules were set out in the Agreement on interpretation and application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, better known as the GATT Subsidies Code. Coccia states that the Subsidies Codes were meant to discourage subsidization of domestic products by the GATT contracting parties and to set the rights of those contracting parties which were affected by any subsidization.[516] The Subsidies Codes contained a procedure for an investigation to determine the existence, degree and effect of any alleged subsidy,[517] an opportunity for the signatory state against whom the allegation was made to clarify the situation[518] and the possible action which could be taken against the signatory state which granted the subsidization.

The WTO as it is known today came into being after the "Uruguay Round Agreements" of 1994 and it does not only deal with trade tariffs but with a number of non-tariff issues, such as intellectual property rights.[519] It consists currently of 164 nations. At present subsidized exports in international trade is governed by the Agreement on Subsidies and Countervailing Measures (the SCM) and all member states have to abide by the subsidy control system set out by this agreement.

The SCM sets out the elements which must be present in order for a subsidy to exist. These are (i) that there must be a financial contribution, (ii) by a government or any public body within the territory of a Member and (iii) that such financial contribution must have led to a benefit.[520] The SCM prohibits subsidies which cause adverse effects and serious prejudice to the interest of member states.[521] Any subsidy granted or maintained by a member state must be notified to the Committee on Subsidies and Countervailing Measures in order for other member states to

[514] JH Jackson *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (2000) 94.
[515] JH Jackson *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (2000) 94.
[516] M Coccia "Settlement of disputes in the GATT under the subsidies code: two panel reports on E.E.C. export subsidies" (1986) 16(1) *Georgia Journal of International and Comparative Law* 1 2.
[517] Article 2 of the Subsidies Code.
[518] Article 3 of the Subsidies Code.
[519] C Reitz "Enforcement of the General Agreement on Tariffs and Trade" (1996) 17(2) *University of Pennsylvania Journal of International Economic Law* 555 557.
[520] See Article 1 of the SCM.
[521] Articles 5 and 6 of the SCM.

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evaluate the trade effects of the subsidy and to understand the operation of the notified subsidy programme.[522] "Prohibited subsidies"[523] in terms of the SCM include:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;
(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

Articles 4 and 7 of the SCM set out the remedies which are available to a member state when it feels that another member state has granted or is maintaining a subsidy. It may request consultation with the member state which is suspected of granting or maintaining the subsidy and if no mutual agreement has been reached within thirty days after the start of the consultation, then the matter gets referred to the WTO's Dispute Settlement Body.[524] There will be a determination whether the subsidy is indeed a prohibited subsidy with adverse effects to the interest of other member states. If it is found to be a prohibited subsidy, the member state in question will be asked to withdraw the subsidy[525] or take appropriate steps to remove the adverse effects.[526] The member state against which a decision is made also has the possibility to appeal the determination. Beside the remedies in Articles 4 and 7, member states affected by subsidies may also implement countervailing duties to offset the effect of any subsidy granted by another member state.[527]

9 2 2 How does the WTO subsidy control system compare with EU state aid control?

It is submitted that the two systems are only comparable in a limited sense. The WTO subsidy control system is aimed at strengthening its import and export tariff controls while the EU state aid control regime is focused on the protection of

[522] Article 25 of the SCM.
[523] Article 3 of the SCM.
[524] Article 4 of the SCM.
[525] Article 4.7 of the SCM.
[526] Article 7.8 of the SCM.
[527] Articles 10 and 19 of the SCM.

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competition and trade within its jurisdiction.[528] The state aid regime is "more constraining on the EU's Member States than the WTO disciplines on subsidies."[529]

There are, however, a number of parallels between the two systems.[530] Firstly, both prohibit certain government actions by their member states. In the case of the WTO it is the provision of subsidies by member states and in the case of the EU it is state aid by member states. The difference is clear though in regard to the meaning of the two concepts. The WTO system only focuses on subsidies while the EU state aid concept is much wider. The EU concept of state aid is comprehensively discussed above in this chapter.[531] Hence it suffices to state here that the state aid notion targets all type of state benefit which an undertaking may receive from a member state, including grants, capital injections, loans, and guarantees.

Secondly, both regimes apply a procedural system which protects member states against unilateral action by other member states.[532] In the EU it starts with the member state's notification of the state and in the WTO with the notification of subsidy programmes to the Committee on Subsidies and Countervailing Measures.[533] If there is no compliance with the procedural rules in the EU, the Commission may start investigative proceedings on its own initiative. In the WTO, however, a prohibited subsidy must be challenged by a member state first, before there are any consequences. The WTO will not start an investigating on its own initiative.[534]

Lastly, just like the EU[535] state aid control regime, the WTO subsidy control regime also affords member states the opportunity to have certain subsidies exempted from the prohibition. Subsidies that are exempted from the WTO subsidy prohibition include (i) assistance for research activities (ii) assistance to disadvantaged regions

[528] See T Jaeger "Distinguishing state and private subsidies: a closer look at the state character test" in J Drexl & V Bagnoli *State-initiated Restraints of Competition* (2015)296 300.
[529] C-D Ehlermann & M Goyette "The Interface between EU State Aid Control and the WTO Disciplines on Subsidies" (2006) 4 *European State Aid Law Quarterly* 695 695.
[530] See in this regard also B Slocock "EC and WTO Subsidy Control Systems - Some Reflections" (2007) 2 *European State Aid Law Quarterly* 249 249-256.
[531] See the comprehensive discussion on the concept of state aid in para 4.2 of this chapter.
[532] See the discussion in paras 6 and 9.2.1 of this chapter respectively on the procedural rules of the EU state aid prohibition and the WTO subsidy control regime.
[533] See the discussions in paras 6 and 9.2.1 of this chapter respectively.
[534] See the discussions in paras 6 and 9.2.1 of this chapter respectively.
[535] See para 5 of this chapter for the discussion on the exemptions in the EU.

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within the territory of a Member; and (iii) assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations.[536]

In the light of the above discussion it is safe to argue that the EU state aid control regime is unique in its scope, coverage and broad enforcement mechanisms It indeed places more constraints on its member states than any of the two systems discussed above.

10 Concluding Remarks

State aid control has emerged as one of the EU competition policy's most pivotal aspects after it was once considered to be the "Cinderella of competition policy".[537] It is now a "visible tool" of economic policy within the EU.[538] The economic stability within the EU is to a certain extent protected by the strict state aid control regime, especially since member states' actions in regard to both private and public undertakings are covered by the state aid rules.

It is more than fifty years since the EEC and the ECSC treaties entered into force and although many treaties have been added to the founding treaties of the EU, the provisions on state aid have only been subjected to minor changes.[539] It nevertheless may be asked whether the state aid regime should not be made more flexible, in order to accommodate the market differences within the various member states. For example, the economy of one member state may be more prone to market failure than the economy of another. In such an instance, the member state where market failure is likely, may not be able to intervene and provide aid to avoid overall failure. Member states however have no option but to subject themselves to the state aid rules when they decide to join the EU. The Brexit[540] debates have shown that not everyone in the EU is happy with the strict rules of the state aid control regime. When deciding which side to support, the "Remain Campaign" or the

[536] Article 8 of the SCM.
[537] F Wishlade "When Policy Worlds Collide: Tax Competition, State Aid, and Regional Economic Development in the EU" (2012) 34(6) *Journal of European Integration* 585 585.
[538] L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Perspective* (2009) 59.
[539] Certain word changes have been added to the current active treaties but the substantial content stayed the same. For example, what was referred to in the EEC Treaty as "enterprises" has now been replaced by the word "undertakings" and reference to the "Common Market" in the EEC Treaty has now been replaced with the word "internal market".
[540] Brexit is commonly accepted to refer to Great Britain's exit from the EU, which is supposed to happen in March 2019 or later if a transitional period is agreed on between the EU and the UK.

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"Leave Campaign", a former British Justice Secretary, Michael Gove, decided to join the "Leave Campaign". In his widely published decision to do so, he inter alia justified his decision on the basis that: "whoever is in Government in London cannot support a steel plant through troubled times. I believe that needs to change."[541] Mr. Gove was referring to the prohibition which the state aid regime places on the provision of aid, which removes the prerogative to decide when and how state aid may be allocated from the domestically elected governments of EU member states. This is perhaps a sentiment shared by others in the EU as well, but since the state aid rules are such an integral part of EU integration, any such sentiments are unlikely to bring about significant change to the basic state aid regime. Some of these concerns were already taken into account when the SAAP, which modernised the state aid rules, was drafted.[542] However, some criticism persists.

Nevertheless, the discussion in this chapter has shown that state aid control can play a positive role in ensuring that SOEs become more efficient, competitive and independent from government funds. Since public undertakings in the EU, which remained part of many member states' economies after the big privatization drive of the 1970s and 1980s, do not have a blanket right to request state aid, they are forced to ensure that they remain financially independent, viable and efficient. Since state aid in the EU can only be provided within the framework of Article 107 of the TFEU and Commission Regulations, there will be no unjustified financial "handouts" by the member states.

In light of the positive role which state aid control could play to create efficient SOEs, the next chapter will propose that it should be possible to transplant the EU concept, with domestic considerations, to a single state such as South Africa to assist its ailing SOEs.

END OF CHAPTER

[541] See http://www.telegraph.co.uk/news/newstopics/eureferendum/12166097/david-cameron-cabinet-leave-brexit-EU-referendum-june-23-live.html (accessed on 20 February 2016).
[542] See the discussion on the SAAP in paras 2 and 8 of this chapter.

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CHAPTER 5: STATE[1] AID TO STATE-OWNED ENTERPRISES IN SOUTH AFRICA: RECOMMENDATIONS FOR A PROPOSED FRAMEWORK FOR STATE AID CONTROL IN SOUTH AFRICA

[1] "State" and "government" are used interchangeably throughout this study.

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1 Reasons for the proposed extension of the application of competition law to state financing of SOEs[2]

1 1 Protecting of the competitive process

1 1 1 Introduction

Countries all over the world, developed and developing, recognise the fundamental need for competition between business enterprises.[3] Those benefiting the most from competition between firms are consumers. Not only do consumers get products and services at competitive prices but competition also stimulates innovation and growth.[4] Hence, the more competition there exists between business enterprises, the

[2] *The Cambridge Business English Dictionary* (Cambridge University Press 2011) abbreviates state-owned enterprises as "SOEs". Although the discussion in this chapter focuses mostly on "national public entities", all recommendations that are made in this chapter should be extended to "provincial public entities" and entities on municipal level as well. Since this study is done from a competition law perspective, commercialised SOEs and those operated in accordance with normal business practices are the focus. Therefore when reference is made to SOEs it should be understood to refer to these types of SOEs unless it is otherwise clearly stated.

[3] This is indicated by the fact that most developing countries now also have competition laws in place. See "The Benefits of Competition Law and Policy for Developed and Developing Countries" (2004) 6(1) *OECD Journal of Competition Law & Policy* 40 40-56. See also D Van Zandt "Competition Law and Policy In Flux: The Developing Country Experience" (2006) 26(3) *Northwestern Journal of International Law and Business* 493 493 where he states that, "The most developed nations of today have prospered in large part due to an increasingly sophisticated set of competition policies and competition law. The successful implementation of competition policy has led to the thriving economies of developed countries, and developing countries aiming to do the same can benefit from the lessons of the developed world. The benefits include the stellar growth, efficiency and stability of today's world powers." See also EM Fox "Competition Policy: The Comparative Advantage of Developing Countries" (2016) 79(4) *Law and Contemporary Problems* 69 69-84.

[4] See OECD "Competition and Poverty Reduction" (http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/GF/WD%282013%2959&docLanguage=En). In its submission to the OECD's Global Forum on Competition the United States of America stated that: "Competition has the potential not only to improve the lot of impoverished economies as a

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more these enterprises will try to create new products and services or improve the existing ones, all of which benefit the consumer. Competition between business enterprises is therefore at the core of a healthy growing economy and as such must be nurtured, protected and encourage at all time. In South Africa this is done in terms of the Competition Act.[5]

Since its inception in 1998, the Competition Act[6] has done well to protect competition in South Africa. Many cartels[7] have been uncovered by the Competition Commission and the necessary penalties for such actions were imposed.[8] Businesses which have been abusing their dominant power within markets have been brought to book. South African competition authorities have been very successful in addressing anticompetitive behaviour. There is therefore no doubt that the Competition Act and the actions that have been taken by the competition authorities in terms of the Act can be hailed as a great success story.[9]

Nevertheless, one issue remains a great challenge to free and fair competition: the various benefits which SOEs enjoy as a result of their state ownership.

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whole, but also to improve the lives of individual consumers. Economies with competitive domestic markets tend to have higher levels and rates of growth in *per capita* income."

[5] See para 5 chapter three for a comprehensive discussion of the Competition Act 89 of 1998. It suffices to restate here that the Act provides a regulatory framework for protecting competitors against anti-competitive behaviour. Chapter two of the Competition Act list all the prohibited practices. These include agreements or concerted practices by firms or decisions by an association of firms which has the effect of substantially preventing or lessening competition in a market or fixing of prices or divides the market or leads to collusive tendering. The abuse of a dominant position in a market is also prohibited. The Act also provides a regulatory framework for mergers because unregulated mergers may "eliminate or stifle" competition.

[6] See para 5 of chapter three for a comprehensive discussion of the Competition Act 89 of 1998.

[7] Justices Wallis and Pillay describe cartels as follows: "Cartel conduct, where ostensible competitors collude to set prices, or terms of trade, or divide markets, fix tenders or engage in similar conduct, is one of the most difficult types of anti-competitive behaviour to identify, prove and bring to an end. This is because a successful cartel is conducted secretly and its continued success depends on its members not breaking ranks to disclose their unlawful behaviour to the competition authorities." See *Agri Wire (Pty) Ltd v Commissioner of the Competition Commission* [2012] 4 All SA 365 (SCA) 367.

[8] See cases such as *Agri Wire (Pty) Ltd v Commissioner of the Competition Commission* [2012] 4 All SA 365 (SCA); *Reinforcing Mesh Solutions (Pty) Ltd v Competition Commission* [2013] 2 CPLR 455 (CAC); *Pioneer Foods (Pty) v Competition Commission in re: Competition Commission v Tiger Brands Ltd t/a Albany; Competition Commission v Pioneer Foods (Pty) Ltd t/a Sasko* [2009] 1 CPLR 239 (CT).

[9] For more on the successes of the competition authorities see for example para 1-7 of the "Annual Report on Competition Policy Developments in South Africa" OECD (2017).
(available at https://one.oecd.org/document/DAF/COMP/AR(2017)51/en/pdf); and par. 1- 5 of "Annual Report on Competition Policy Developments in South Africa" OECD (2015). See also D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013).

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1 1 2 To what extent do competition laws at present apply to SOEs and the financing of SOEs by the state in South Africa?

Like many competition law regimes worldwide, South Africa's competition legislation follows closely that of the United States and the EU.[10] It regulates certain prohibited practices by firms and mergers between firms.[11] Hence, the focus of competition law in South Africa is the behaviour of firms. In accordance with the Competition Act a firm includes a person, partnership or a trust.[12] For purposes of the merger regime[13] a firm may be the "acquiring firm", the "primary acquiring firm", the "target firm" or the "primary target firm" and for purposes of the "prohibited practice regime"[14] a firm may be a dominant firm or a party to an agreement or concerted practice which prevents or lessens competition in a market.

The Competition Act applies to all economic activity within or those having an effect within South Africa with very few exceptions.[15] At present there is no exact definition of what "economic activity" for purposes of the Competition Act entails and Sutherland and Kemp correctly point out that not "every activity which has economic consequences can be so described."[16] Hence, the authors are of the opinion that this needs to change and a more precise meaning needs to be developed for purposes of the Competition Act.[17] Until that moment, however, for as long as an activity by a firm has economic consequences, that activity will come within the ambit of the concept. South Africa is not the only country where it is difficult "to draw a hard line between economic and non-economic activities" for purposes of competition law. This is also a matter which the EU courts have grappled with extensively since the EU treaties, like the South African Competition Act, do not have an exact definition of

[10] See the discussion of US and EU competition law in para 4.3.2 and para 4.3.7 of chapter three respectively.
[11] See the discussion on South African competition law in para 4.3.8 of chapter three.
[12] Section 1 of the Competition Act 80 of 1998.
[13] Chapter three of the Competition Act 89 of 1998 regulates mergers in South Africa.
[14] Chapter two of the Competition Act 89 of 1998 regulates prohibited practices in South Africa.
[15] The Competition Act lists the following as being exempted from the application of Article 2 (1): collective bargaining and collective agreements as defined in the Labour Relations Act 66 of 1995 as well as concerted conduct which is designed to achieve as non-commercial socio-economic objective or similar purpose.
[16] See para 4.4 of chapter 4 of P Sutherland & K Kemp *Competition Law of South Africa* (2017).
[17] See para 4.4 of chapter 4 of P Sutherland & K Kemp *Competition Law of South Africa* (2017).
For more reasons why perhaps a more precise meaning of "economic activity" is required see para 4.4 of chapter 4 of the aforementioned book.

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the notion.[18] Since EU competition law only applies to undertakings which conduct economic activity,[19] it was important for EU courts to determine what is considered to be an economic activity for purposes of EU competition law. South African competition law could in future draw on that meaningful interpretation for the advancement of its own notion.

The EU Commission, which is responsible for enforcing EU competition law, previously stated that the question of how to distinguish between economic and non-economic services has often been raised but an answer cannot be given a *priori* and requires a case-by-case analysis.[20] Therefore there is extensive case-law on the concept in the EU. The case- law has established criteria which are used to classify the nature of an activity for purposes of EU competition law. The basic test is whether the entity in question is engaged in an activity which consists in offering goods and services on a given market and which could, at least in principle, be carried out by a private actor in order to make profits.[21] An activity may thus be of an economic nature[22] if it requires participation in a market or the carrying on of an activity in a market context.[23] Case-law[24] has thus established a clear link between participation in a market and the carrying on of an economic activity.[25]

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[18] See E Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (2007) 9-10 and E Kloosterhuis "Defining non-economic activities in competition law" (2017) 13(1) *European Competition Law Journal* 117-149.

[19] See *Höfner v Macrotron GMBH* Case C-41/90 EU:C:1991:161 paras 21-22

[20] *Communication on a single market for 21st century Europe--Services of general interest, including social services of general interest: a new European commitment* COM(2007) 725 final 5.

[21] See the Opinion of Advocate General Jacobs delivered on 17 May 2001 in Case C-475/99 *Ambulanz Glöckner v Landkreis Südwestpfalz* ECLI:EU:C:2001:577 para 67. See also Case 118/85 *Commission v Italy* [1987] ECR 2599 para 7; Case C-35/96 *Commission v Italy* [1998] ECR I-3851 para 36; and Case C-309/99 Wouters v *Algemene Raad van de Nederlandse Orde van Advocaten* [2002] ECR I-1577 para 46 and Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 A*OK Bundesverband v Ichthyol Gesellschaft Cordes* [2004] E.C.R. I-2493 paras 47-51.

[22] See the written Opinion of Advocate General Poiares Maduro delivered on 10 November 2005 in *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 13.

[23] See the written Opinion of Advocate General Poiares Maduro delivered on 10 November 2005 in *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 13.

[24] See Case C-35/96 *Commission* v *Italv* [1998] ECR 1-3851 para 37; Joined Cases C 180/98 to C-184/98 *Pavlov and Others* [2000] ECR I-6451 para 75 and *Case C-475/99 Ambulanz Glöckner v Landkreis Südwestpfalz* ECLI:EU:C:2001:577 para 19.

[25] See the written Opinion of Advocate General Poiares Maduro delivered on 10 November 2005 in *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 13.

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In his written opinion on *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities,*[26] Advocate General Maduro stated that it is both the fact that an activity may be carried on by private operators and that the activity is carried on under market conditions that is decisive in regard to its economic nature.[27] He further stated that market conditions are distinguished by conduct which is undertaken with the objective of capitalisation, which is incompatible with the principle of solidarity. The principle of solidarity which is fundamental to both domestic and Union law[28] requires that the application of the EU competition rules be excluded.[29] Boeger[30] states that the solidarity principle acts both as a "buttress" that shields the member states' competences from EU competition law and upholds the political rights of the member states' citizens to decide collectively how much solidarity they wish to extend towards one another. Hence, it has been accepted in the EU that certain activities in the public interest and those which forms part of the essential functions of the State are not economic in nature. Examples include maintenance and improvement of air navigation safety,[31] the protection of the environment,[32] the management of the public social security system, including sickness funds[33] and sickness funds which are entitled in accordance with German legislation to the fixed maximum amounts payable by them in respect of the cost of medicinal products.[34] Even so, only because certain tasks are entrusted to public agencies, the economic nature of such tasks is not automatically removed from the scope of competition law. In *Höfner v Macrotron*

[26] ECLI:EU:C:2006:453.
[27] See the written Opinion of Advocate General Poiares Maduro delivered on 10 November 2005 in *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 13.
[28] See "Commission Decision of 19 December 2012 on State aid SA.20829 (C 26/2010, ex NN 43/2010 (ex CP 71/2006)) Scheme concerning the municipal real estate tax exemption granted to real estate used by non-commercial entities for specific purposes implemented by Italy" *Official Journal of the European Union* L 166 18/06/2013 para 50.
[29] See Advocate General Maduro's written Opinion on *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 10. See also N Boeger "Solidarity and EC competition law" (2007) *European Law Review* 32(3) 319-340.
[30] N Boeger "Solidarity and EC competition law" (2007) 32(3) *European Law Review* 320.
[31] See Case C-364/92 *SAT Fluggesellschaft (Eurocontrol)* [1994] ECR I-43.
[32] See Case C-343/95 *Diego Cali & Figli* [1997] ECR I-1547.
[33] *Christian Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon* ECLI:EU:C:1993:63.
[34] Joined Cases C 264/01, 306/01, 354/01 & 355/01, *AOK Bundesverband v Ichthyol-Gesellschaft Cordes, Hermani & Co* [2004] E.C.R. I-2493.

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GMBH[35] the CJEU noted that employment procurement entrusted to a public agency, the German Bundesanstalt für Arbeit (Federal Office for Employment), is an economic activity.[36] In *Ambulanz Glöckner v Landkreis Südwestpfalz*[37] the court stated that the provision of public ambulance service, which in Germany was entrusted to the administrative districts of each State ('Landkreise') and the towns which are administrative districts in their own right ('Kreisfreie Städte'), constitute an economic activity for purposes of the application of competition law. Therefore each activity is analysed on a case-by-case basis. Advocate General Maduro stated that EU case-law has shown that it is essential to consider each activity carried out separately in order to determine whether it should be classified as an economic activity and that such a separate classification is even more necessary where a public body is concerned, as it can act as an economic operator in relation to one activity, while at the same time carrying on functions that are non-economic in nature.[38] When an entity carries on such "mixed activities", it is subjected to competition law only in respect to the part of its activities which is of an economic nature.[39] In sum, in the EU as long as an activity consist firstly, of the offering of goods and services on a given market and secondly, has the ability to generate profit, it will be classified as economic activity[40] regardless of the fact that it is delivered by a public entity.

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[35] Case C-41/90 EU:C:1991:161 paras 21-22.

[36] Joined cases C-159/91 and C-160/91 *Christian Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon* ECLI:EU:C:1993:63. The court state in this case that: "Sickness funds, and the organizations involved in the management of the public social security system, fulfil an exclusively social function. That activity is based on the principle of national solidarity and is entirely non-profit-making. The benefits paid are statutory benefits bearing no relation to the amount of the contributions. Accordingly, that activity is not an economic activity and, therefore, the organizations to which it is entrusted are not undertakings within the meaning of Articles 85 and 96 of the Treaty."

[37] Case C-475/99 *Ambulanz Glöckner v Landkreis Südwestpfalz* ECLI:EU:C:2001:577. The court stated: "In the present case, the medical aid organisations provide services, for remuneration from users, on the market for emergency transport services and patient transport services. Such activities have not always been, and are not necessarily, carried on by such organisations or by public authorities. According to the documents before the Court, in the past Ambulanz Glöckner has itself provided both types of service. The provision of such services therefore constitutes an economic activity for the purposes of the application of the competition rules laid down by the Treaty."

[38] See Advocate General Maduro's written Opinion on *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 43.

[39] See Advocate General Maduro's written Opinion on *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* ECLI:EU:C:2006:453 para 68.

[40] Case 118/85 Commission v Italy [1987] ECR 2599 para 7; Case C-35/96 Commission v Italy [1998] ECR I-3851 para 36; and Case C-309/99 Wouters [2002] ECR I-1577 para 46.

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South Africa's SOEs carry on activities which consist of offering goods and/or services on a relevant market and generate profits but also have public interest functions. Hence, many of them also have "mixed activities". SAA, PRASA and the SABC are only a few examples. When referring to the phrase "all economic activity" as found in section 3(1) of the Competition Act, the court in *Standard Bank Investments Corporation Ltd v The Competition Commission*[41] noted that "These words of great generality extend its operation to the countless forms of activity which people undertake in order to earn a living. But the extension is not unlimited, as the existence of the five exceptions (*a*) to (*e*) proclaims." Beside those exceptions listed in section 3 of the Competition Act, South Africa like the EU, might also in future have to develop specific criteria in order to classify activities as economic even if each activity is still evaluated on an individual basis, much like the position in the EU.

Section 81 of the Competition Act extends its application to the state. It provides that the Competition Act binds the State. The Competition Tribunal of South Africa made it clear though, that Section 81 of the Competition Act only binds the state when it acts through a firm such as a state entity which competes in a market firstly through the selling of goods and services and secondly by generating a turnover or acquiring assets.[42] Once these requirements are met, "The Act is so constructed that public entities enjoy neither preference nor prejudice by virtue of their official status when their actions are considered in terms of the Act."[43]

When the state acts through a firm such as an SOE, which competes in a market by selling goods or services and generates a turnover or acquires assets, it is performing an economic activity and because of section 81, the Competition Act will be applicable.[44] The economic activities of SOEs therefore fall within the ambit of the Competition Act.[45] In this regard, the South African competition regime is in line with the majority of competition law regimes all over the world, which regulate the

[41] 2000 JDR 0129 (T) para 9.
[42] *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy* [2009] 2 CPLR 379 (CT) para 19.
[43] *Phutuma Networks (Pty) Ltd v Telkom SA Ltd* [2011] 1 CPLR 213 (CT) 221.
[44] See *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy* [2009] 2 CPLR 379 (CT).
[45] See *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy* [2009] 2 CPLR 379 (CT) 384 where the Competition Tribunal of South Africa stated that "it does seem to us that this [Section 81] applies when the State acts qua firm i.e. a State owned entity that is a firm that competes in a market by selling goods and services generating a turnover or acquiring assets."

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activities of private enterprises and not necessarily the sovereign activities by the state.[46] Hence, the Competition Tribunal is correct when it noted that it does not have the competence to instruct the state how to act or not to act outside of the competition law boundaries.[47]

When the South African government allocates state aid to SOEs, it is neither acting as a firm nor is it executing an economic activity which will trigger the application of the competition laws. Hence the allocation of state aid is immune from current South African competition laws. At present there is very little that can be done to protect competitors in South Africa in these circumstances as the granting of state aid is not covered by the scope of the competition laws.

1 1 3 Harm to competition that can be done by granting state aid to SOEs

The statement by Peter Sutherland, a former EU Competition Commissioner, on the harm which state aid can cause to competition summarises one of the core submission of this study when he says that "Government aid to industry can be as damaging from the competition point of view as anticompetitive behaviour by enterprises, if not more so."[48] Benefits and privileges bestowed on SOEs by the state take different forms. Geddes correctly summarises the position with regard to the benefits and privileges which SOEs enjoy due to their state ownership:

> "Government firms are often endowed with government-granted privileges and immunities not enjoyed by private rivals. Those benefits may include monopoly

[46] The exclusion of state acts which may harm competition from the scope of competition law is however changing in many jurisdictions as more and more competition law regimes start to regulate even sovereign activities by states if such activities could potentially be harmful to competition as long as such regulation does not interfere with the state's ability to govern. See for example TJ Muris "Principles of a Successful Competition Agency" (2005) 72 (1) *University of Chicago Law Review* 170 where the author states that: "While antitrust law most often involves enforcement against private parties, competition agencies must also consider the effects of government actions. Protecting competition by focusing solely on private restraints is like trying to stop the water flow at a fork in a stream by blocking only one channel. A system that sends private price fixers to jail, but makes government regulation to fix prices legal, has not completely addressed the competitive problem. It has simply dictated the form that the problem will take." See also EM Fox and D Healey "When the State Harms Competition- the Role for Competition Law" (2014) 79 (3) *Antitrust Law Journal* 769-820

[47] *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy* [2009] 2 CPLR 379 (CT) para 20.

[48] P Sutherland "EEC Competition Policy" (1985) 54 *Antitrust Law Journal* 667 670.

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> power, credit guarantees, freedom from paying investors an expected rate of return, exemption from bankruptcy, tax exemptions, direct subsidies, and immunity from antitrust prosecution, disclosure requirements, and other regulations. All such privileges are valuable. Those privileges give government firms an artificial competitive advantage over private rivals. By artificial, I mean that government firm's competitive advantage is not based on economic factors such as superior management skills, more efficient technology, enhanced innovation, better labor relations, better corporate governance, or harder work. The firm's competitive advantage is an artefact of its government-granted benefits."[49]

Such benefits and privileges may impact significantly on the private competitors of SOEs and on free and fair competition. It provides SOEs which conduct economic activity with an "artificial competitive advantage".[50]

The EU is the only jurisdiction which has a state aid control regime[51] as an integral part of its competition framework which ensures that any such harm is limited or excluded. However, the threat to free and fair competition by state aid generally, not only in the EU, has been widely acknowledged by various scholars.[52] It is also clear that ordinary competition rules are insufficient to control these risks to the competitive process. Sokol, for example, observes that government intervention comes with risks to competition and states that the impact of SOEs on competition "is significant and will continue to be for some time".[53] Adamantopoulos[54] notes that the threat posed to free and fair competition by public undertakings (SOEs in South Africa) is twofold.

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[49] RR Geddes "Introduction" in RR Geddes (ed) *Competing with the Government: Anticompetitive Behavior and Public Enterprises* (2004) xi xi.
[50] RR Geddes "Introduction" in RR Geddes (ed) *Competing with the Government: Anticipative Behavior and Public Enterprises* (2004) xi xii.
[51] See chapter four for a comprehensive discussion of the EU state aid rules.
[52] EM Fox & D Healey "When the State harms Competition- The role for Competition Law" (2014) 79(3) *Antitrust Law Journal* 769 769-820; RR Geddes *Competing with the Government: Anticompetitive Behavior and Public Enterprises* (2004); and TK Cheng, I Lianos & DD Sokol *Competition and the State* (2014).
[53] DD Sokol "Anticompetitive Government Regulation" in DD Sokol & I Lianos (eds) *The Global Limits of Competition Law* (2012) 83 85.
[54] K Adamantopoulos "State Aid and Public Undertakings with Specific Reference to the Airline Sector" in A Biondi, P Eeckhout & J Flynn (eds) *The Law of State Aid in the European Union* (2004) 219 219-220.

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- Firstly, the possible cross-over from the State's role as "public authority and protector of a public interest and its capacity as owner of the particular undertaking" is part of the threat.
- Secondly, there is "the danger posed by the sheer quantum of the State's resources and the possibility that they could be used to distort competition".[55]

Verouden[56] argues that:

> "Subsidies to firms present us with something of a dilemma. On the one hand, subsidies are given by public authorities so one would hope for sound public policy reasons. For instance, subsidies are given to promote R&D [research and development] activity, to foster environmental protection or to improve the fate of certain disadvantaged regions. On the other hand, subsidies that are given to some firms but not to others may distort competition between these firms"

The South African competitive process is also not immune to this threat. In South Africa the threat to free and fair competition by state aid to SOEs in any form, whether by guarantees, subsidies, indemnities or securities, is a genuine concern.[57] SOEs in South Africa can frequently rely on direct state benefits which sets them apart from their private competitors. The harm that state aid to SOEs could cause to the competitive process was show-cased in a recent case in the High Court, even though the court did not decide on the issues relating to competition. In June 2015 the North Gauteng High Court found that a R5 billion guarantee to SAA, which in every sense qualifies as state aid, is not unfair after Comair, a "franchise partner" of British Airways which operate within South Africa, wanted the court to declare the government's decision to provide the guarantee to SAA unlawful and unconstitutional and for the guarantee to be reviewed and set aside.[58] Comair argued that the decision to grant the guarantee "clearly leads to a distortion of the market, because it requires no specific alteration by SAA of the very conduct that has caused its

[55] K Adamantopoulos "State Aid and Public Undertakings with Specific Reference to the Airline Sector" in A Biondi,P Eeckhout & J Flynn (eds) *The Law of State Aid in the European Union* (2004) 219 219-220.
[56] V Verouden "EU State Aid Control: The Quest for Effectiveness" (2015) 4 *European State Aid Law Quarterly* 459 459.
[57] Such concerns have been manifested, for example, in case law against SAA. See for example *Comair Ltd v Minister of Public Enterprises* 2016 (1) SA 1 (GP).
[58] See *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP).

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financial difficulties, and reflected great harm upon firms that compete under the commercial disciplines of the market".[59] The court however, did not reach its decision based on issues which the South African competition authorities have to investigate and decide on, such as Comair's allegations of market distortion and anti-competitive behaviour. In this regard it pointed out the principles established by the Constitutional Court in *Gcaba v Minister of Safety and Security*[60] which states that from the moment rules and structures have been created for the speedy and effective resolution of disputes and protection of rights in a particular area of law, it is preferable for that system to be used. The court thus stated that it cannot entertain the matters which are within the jurisdiction of the competition authorities. It therefore based its decision on Comair's allegations regarding the principle of legality and certain provisions of the Promotion of Administrative Justice Act 3 of 2000 (PAJA) which Comair was relying on.

State aid to SOEs may impact on the competitive process in various ways.

Firstly, free and fair competition within markets is known to foster innovation.[61] Moses and others state that in order to be "competitive in the global economy, it is critical for organisations, industries and countries to innovate" and that innovation is a "key driver of long-term economic growth, competitiveness and a better quality of life.[62] The possibility of unlimited state aid to SOEs may impact on the willingness by private competitors to innovate. Geddes states that efficient private competitors may reduce their investment in new activities if there is "significant government competition or uncertainty about future government competition".[63] Innovation refers to "the process of transforming an idea, generally generated through research and development, into a new or improved product, process or approach, which relates to the real needs of society and which involves scientific, technological, organisational

[59] See *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP).
[60] 2010 (1) SA 238 (CC).
[61] See the discussion on innovation in para 2 and para 4.2 of chapter 3. See also N Godfrey "Why is Competition important for growth and poverty reduction" OECD Global Forum on International Investment 27-28 March 2008 3; M Neumann *Competition Policy History, Theory and Practice* (2001) 14; and H Cefrey *The Sherman Antitrust Act: Getting Big Business Under Control* (2004) 6.
[62] C Moses, MM Sithole, W Blankley, D Labadarios, H Makelane & N Nkobole "The state of innovation in South Africa: findings from the South African National Innovation Survey" (2012) 108 (7-8) *South African Journal of Science* 1 1.
[63] RR Geddes "Case Studies of Anticompetitive SOE Behavior" in RR Geddes *Competing with the Government: Anticompetitive Behavior and Public Enterprises* (2004) 27 53.

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or commercial activities".[64] South Africa's seriousness about innovation as part of its policies for economic growth is reflected in various pieces of legislation such as the National Advisory Council on Innovation Act[65] and the Technology Innovation Agency Act.[66] These Acts establish a National Advisory Council on Innovation which, inter alia, advises on the co-ordination and stimulation of the national system of innovation and the promotion of co-operation within the national system of innovation[67] and a Technology Innovation Agency "to support the State in stimulating and intensifying technological innovation in order to improve economic growth and the quality of life of all South Africans by developing and exploiting technological innovations"[68] respectively. It is also reflected in the number of institutions which forms part of South Africa's "National Innovation System". These include, inter alia, the Council for Scientific and Industrial Research (CSIR), the Human Sciences Research Council (HSRC) and the Medical Research Council (MRC).[69] The South African government has introduced a number of "support mechanisms" to promote innovation, inter alia, the R&D Tax Incentive Programme, which is available for businesses of all size, the Industry Innovation Partnership, which provides co-funding to support innovation initiatives and Technology Stations, which provide science, engineering and technology services to small, medium and micro enterprises (SMMEs) and entrepreneurs to help them, for example, with product development and product improvement.[70] SOEs which are part of the portfolio of the Ministry of Public Enterprises and even those outside of this Ministry's portfolio are

[64] Section 1 of the National Advisory Council on Innovation Act No 55 of 1997.
See also I Booyens "Are small, medium- and micro-sized enterprises engines of innovation? The reality in South Africa" (2011) 38(1) *Science and Public Policy* 67 67 where innovation is described as "the creation of new products, services, processes and organisational methods, or adaptations of those that exist, based on new knowledge."
[65] Act 55 of 1997.
[66] Act 26 of 2008.
[67] Section 4 of the National Advisory Council on Innovation Act 55 of 1997.
[68] Section 3 of Technology Innovation Agency Act 26 of 2008.
[69] For more on these institutions see H Zhang *National Innovation Systems: South Africa and China Compared* PhD thesis Stellenbosch (2012). See also ST Manzini "Measurement of Innovation in South Africa: An Analysis of Survey Metrics and Recommendations" (2015) 111(11-12) *South African Journal of Science* 1 1-8; and C Moses, MM Sithole, W Blankley, D Labadarios, H Makelane & N Nkobole "The state of innovation in South Africa: findings from the South African National Innovation Survey" (2012) 108 (7-8) *South African Journal of Science* 1 1-5.
[70] See the National Business Innovation Survey 2014-2016 (http://www.hsrc.ac.za/uploads/pageContent/8566/BUSINESS%20INNOVATION%20SURVEY%202014-2016%20_BROCHURE.pdf).

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considered to be "R&D [research and development] performing SOEs."[71] As such these enterprises may get extensive public financial support as active market participants to innovate. This may result in a situation where there may not be proper reward for private enterprises which operate within the market of the SOE to innovate. Firstly, an SOE which obtains public funds for innovation may develop new products and services which are similar to those of the private enterprise. Secondly, because of subsidization by the government, the SOE may then offer those new products and services at a lower price than the private competitor does. This may create a position which might not be ideal for private enterprises in regard to their aims of profit maximization and return on investment for shareholders. Some forms of innovation, such as very high risk innovation, may indeed be more appropriately done through state intervention but Mazzucato and Semieniuk are correct when they state that "there is no automatism whereby public involvement in financing innovation leads to superior outcomes".[72]

Secondly, free and fair competition between enterprises encourages entrepreneurship which leads to benefits for consumers.[73] Entrepreneurship is important for economic development.[74] Booysens is therefore correct when she states that almost every business or organisation has its origins in the activities of entrepreneurs.[75] State aid to SOEs has the potential to stifle entrepreneurship. Prospective entrepreneurs might be intimidated by the presence in a market of a SOE which has the unlimited ability to obtain financial aid from the government. Less entrepreneurship may lead to fewer competitors in sectors of the economy.

Thirdly, free and fair competition encourages new entries into sectors of the economy which might prevent dominance by incumbent enterprises. However, government subsidies and privileges may cause potential competitors to be unwilling

[71] M Kahn "Rhetoric and Change in Innovation Policy: The Case of South Africa" (2013) 18(2) *Science, Technology and Society: An International Journal* 189 200.
[72] M Mazzucato & G Semieniuk "Public financing of innovation: new questions" (2017) 33(1) *Oxford Review of Economic Policy* 24 42.
[73] For additional reading on competition and entrepreneurship see IM Kirzner *Competition and Entrepreneurship* (1973).
[74] J Munemo "Entrepreneurship in Developing Countries: Is Africa Different?" (2012) 17(1) *Journal of Developmental Entrepreneurship* 1 1.
[75] I Booysens "Are small, medium- and micro-sized enterprises engines of innovation? The reality in South Africa" (2011) 38(1) *Science and Public Policy* 67 68.

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to enter a market where there is an SOE which may at any time rely on government financial assistance. This may allow SOEs to become powerful market players. Take for example the airline industry in South Africa. Over the years South Africans have seen numerous airlines come and go. At least two have blamed their demise on the uncompetitive behaviour of SAA.[76] SAA is the one airline that continues to operate, albeit under constrained financial conditions. The airline has been saved from bankruptcy by the government on many occasions. This privilege was not bestowed on its competitors who had to go out of business when their financial matters were not in order. The state of affairs which is present in South Africa's airline industry has the potential to deter new entrants from entering the domestic airline market. The founder of Nationwide Airline, Vernon Bricknell, recently said that "he will never go into the airline industry in South Africa again, unless the playing fields are levelled and he would be spared fighting SAA with its deep pockets all the time."[77] This position is present in many sectors where SOEs operate. It is submitted that the entry into markets by potential new market entrants might increase substantially if potential market entrants are aware that state aid control rules will always serve as some kind of protection from unguided aid to an SOE in the market.

Lastly, SOEs are often found guilty of uncompetitive behaviour and administrative fines have frequently been imposed on them.[78] Litigation on anticompetitive practices committed by commercialised SOEs in South Africa is a regular occurrence in South Africa. SOEs may "have stronger incentives than profit- maximizing firms to pursue activities that disadvantage competitors"[79] Sappington and Sidak state that such increased incentive to disadvantage competitors may be a result of governmental

[76] See para 1.2 (a) for the reference to domestic airlines such as Nationwide and 1Time.

[77] https://www.moneyweb.co.za/news/south-africa/ill-have-saa-liquidated-if-they-dont-pay-former-nationwide-ceo/).

[78] See for example cases such as *Nationwide Airlines (Pty) Ltd v South African Airways (Pty) Ltd* [2009] 2 CPLR 509 (CT); and *The Competition Commission v South African Airways (Pty) Ltd* [2005] 2 CPLR 303 (CT) where the Competition Act was applied to the conduct and behaviour of SOEs. The payment of a penalty may impact on an SOE's finances and as a result the SOE may require financial assistance. Even though the amount of the administrative penalty is paid into the National Revenue Fund,[78] it does not detract from the fact that the stability of the SOE's financial position might be disrupted by such a penalty which as a result might lead to the requirement for state funds.

[79] DEM Sappington & JG Sidak "Anticompetitive Behaviour by State-Owned Enterprises: Incentives and Capabilities" in RR Geddes (ed) *Competing with the Government: Anticompetitive Behavior and Public Enterprise* (2004) 1 2.

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policy or other forces which place emphasis on revenue or output of the SOEs.[80] The authors state that the emphasis on revenue or output may result in "aggressive action in pursuit of expanded output and revenue, including anticompetitive behavior against private, profit-maximizing enterprise."[81] They list the potential anticompetitive activities as (i) setting prices below cost; (ii) misstating of costs;(iii) the choosing of inefficient technologies to circumvent restrictions on below-cost pricing; raising the operating costs of existing rivals; and erecting entry barriers to preclude the operation of new competitors.[82] In South Africa increased incentives may also be created by government policies which make it difficult for SOEs to cut costs, such as moratoria on retrenchments as well as costly public interest mandates. In order to be sustainable while at the same time complying with these policy mandates, SOEs are almost forced to engage in excluding and harming of competitors. Williams and Al-Shabaz propose that state or private ownership as such would not necessary impact on the efficiency of a firm. However, they accept that "[s]ince governments often use state-owned companies as vehicles for the advancement of policies other than generating a stream of income, the companies often are not operating under comparable conditions."[83] It is this aspect that may serve as an incentive for anti-competitive conduct in South Africa. Hence, state aid control rules could have a greater disciplinary effect which could strengthen SOEs as competitive entities. SAA for example continues to get state aid to keep it going as a business concern[84] whilst the airline is also one of the repeat offenders under the Competition Act. SAA has on various occasions committed anti-competitive behaviour which led to prejudice to other competitors in South Africa's domestic air transport sector.[85] One example of

[80] DEM Sappington & JG Sidak "Anticompetitive Behaviour by State-Owned Enterprises: Incentives and Capabilities" in RR Geddes (ed) *Competing with the Government: Anticompetitive Behavior and Public Enterprise* (2004) 1 2.
[81] DEM Sappington & JG Sidak "Anticompetitive Behaviour by State-Owned Enterprises: Incentives and Capabilities" in RR Geddes (ed) *Competing with the Government: Anticompetitive Behavior and Public Enterprise* (2004) 1 2.
[82] DEM Sappington & JG Sidak "Anticompetitive Behaviour by State-Owned Enterprises: Incentives and Capabilities" in RR Geddes (ed) *Competing with the Government: Anticompetitive Behavior and Public Enterprise* (2004) 1 2.
[83] TJ Farer "Privatization as an International Phenomenon" (1993) 87 *American Society International Law Proceedings* 105 109.
[84] The National Treasury recently announced that it was giving SAA funds in terms of section 16 of the PFMA. Section 16 of the PFMA deals with the use of funds form the National Revenue Funds in emergency situations. See the media statement "Recapitalisation of the South African Airways" (at http://www.treasury.gov.za/comm_media/press/2017/2017070101%20SAA%20recapitalisation.pdf).
[85] See for example *Comair Ltd v Minister of Public Enterprises* 2016 (1) SA 1 (GP) 5.

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its anticompetitive behaviour is the various incentive scheme agreements,[86] which SAA concluded with travel agents between 1999 and 2005. In terms of some of the incentive schemes travel agents were paid a commission to sell SAA domestic tickets instead of those of its competitors. Two recent successful cases by Nationwide Airlines (Pty) Limited,[87] one of SAA's former competitors, and Comair (Pty) Limited,[88] an existing competitor of SAA respectively, shows the unacceptable anticompetitive behaviour by a SOE which has become dominant through state support. Nationwide was awarded damages in the sum of R104.625 million because of SAA's anti-competitive conduct while Nationwide was still in operation and Comair was awarded R552 million altogether on the basis of its combined damages claim (damages in the sums of R104,2 million and R450,0 million for its two claims respectively).[89] But even with repeated fines issued against SAA by the competition authorities and successful claims against it for damages, SAA continues to maintain market power in the domestic airline industry. It would seem that the fines and damages awarded will not necessarily stop it from committing anti-competitive acts.

1 1 4 State aid regulation as a means of addressing competition concerns with state aid to SOEs

In the Preamble to the Competition Act it is stated that an efficient, competitive economic environment will benefit all South Africans. This ideal may not be fully

[86] See *Nationwide Airlines (Pty) Ltd v South African Airways (Pty) Ltd* [2009] 2 CPLR 509 (CT); See also *Comair Ltd v South African Airways (Pty) Ltd* [2016] 2 CPLR 419 (GJ).
[87] *Nationwide Airlines (Pty) Ltd (In Liquidation) v South African Airways (Pty)* [2016] 4 All SA 153 (GJ).
[88] *Comair Ltd v South African Airways (Pty) Ltd* [2017] 2 All SA 78 (GJ).
[89] The court also ordered SAA to pay interest of 15.5 % on the two amounts, which will run from 9 January 2006 to date of final payment and 24 February 2010 to date of final payment respectively. SAA also has to pay the cost order made by the court. SAA appealed to the SCA against the judgement of the Gauteng Local Division. It wanted the SCA to look into whether the damages were correct and appropriately determined and whether the correct methodology was used by the Gauteng Local Division. The case was enrolled on the SCA court roll for February as "*South African Airways SOC Limited v Comair Limited* (782/2017)". See http://www.justice.gov.za/sca/bulletin/2019_01.pdf. However, before the appeal was heard by the SCA, SAA and Comair entered into a final settlement agreement which was made an order of court by the SCA. Hence, SAA decided to withdraw its appeal. Subsequently, in February 2019, Comair made the following announcement regarding the settlement agreement to its shareholders: "In terms of the Settlement Agreement, SAA will pay Comair a settlement amount of R1 108 040 000 plus interest ("Settlement Amount"). The Settlement Amount will be made in accordance with a payment schedule commencing on 28 February 2019 and terminating on 28 July 2022, or earlier should SAA elect to make payments earlier than agreed. In addition, SAA will pay Comair's taxed legal costs incurred to date. Both Comair and SAA will withdraw the appeal and cross-appeal currently pending before the SCA" (http://www.comair.co.za/Media/Comair/files/sens/sens-15-feb-2019-saa-damages-claim-settlement-agreement.pdf).

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realised if unlimited state aid is provided to SOEs. It is submitted that the unregulated allocation of state aid to economically engaged SOEs may undermine the various goals of the Competition Act and affect the overall success of competition policy. The Competition Act itself makes no reference to the compatibility of state aid with competition legislation. However, aims such as the provision to consumers of competitive prices and product choices and to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy may be jeopardised if the allocation of state aid causes certain sectors of the economy to be dominated by SOEs.

It is submitted that if the state continues to be a player in the market, which it is entitled to do, measures should be in place to ensure that enterprises owned by the state compete with their private counterparts on a level playing field. In this context Weaver correctly notes that state aid control and the rest of competition law has the same aim namely to create a level playing field for competitors.[90] There are no legislative provisions which address the competition concerns which state aid may raise in South Africa.[91] It is submitted that the basic principles of competition law should be applied to the provision of state aid where aid is given to SOEs that are operating as a commercial enterprise. The law should ensure that competitive neutrality[92] is observed in respect of SOEs which are commercialised and operate in accordance with normal business principles. Competitive neutrality "occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages."[93] Adamantopoulos states that the application of a neutrality principle ensures scrutiny when the state financially intervenes in regard to the affairs of a public undertaking.[94] In light of the above, the regulation of state aid as an option to achieve competitive neutrality and to ensure free and fair competition amongst all enterprises in South Africa is explored in this chapter.

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[90] AM Weaver "Convergence through the Crisis: State Aid Modernization and West European Varieties of Capitalism" (2015) 21 *Columbia Journal of European Law* 587 601.
[91] See the discussion in para 1.2 (c) of this chapter.
[92] For a detailed discussion of the competitive neutrality principle see OECD *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business* (2012) 1-119.
[93] OECD *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business* (2012) 9.
[94] K Adamantopoulos "State Aid and Public Undertakings with Specific Reference to the Airline Sector" in A Biondi, P Eeckhout & J Flynn *The Law of State Aid in the European Union* (2004) 219 220.

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It is however important to remain mindful of the difficulties[95] of applying competition law to state financing of SOEs in South Africa. The granting of state aid to SOEs in South Africa continues to be important "political decisions". The proposals made in this chapter will take such difficulties into account. This study also takes note of Judges Davis and Jali's[96] caution in *Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission*[97] that great care should be taken before applying principles borrowed from other competition law regimes. However, it is also important to note that certain aspects of South African competition law could make the implementation of a state aid control regime in South Africa plausible. The competition regime already goes beyond "traditional antitrust concerns". Beside traditional objectives of antitrust, South African competition law is also used "to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons".[98] The provision in section 2 (f) of the Competition Act has widened South Africa's competition laws beyond "traditional anti-trust concerns". The South African competition authorities are stepping into spheres which normally do not fall within the framework of competition policy. This is because of section 9(2) of the Constitution which recognizes that it might be necessary for legislation and other measures to be adopted to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination. Section 2(f) seems to have included the Competition Act as legislation that falls into this category as this provision seeks to recognize that the Act serves as a corrective measure aimed at rectifying previous discrimination or disadvantage in the form of economic exclusion. Accordingly, both the Preamble and section 2(f) of the Competition Act expresses the spirit of the Constitution. Another indication of the

[95] See the discussion on these difficulties in para 2 of this chapter.
[96] *Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission* 2005 (6) BCLR 613 (CAC) 616.
[97] *Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission* 2005 (6) BCLR 613 (CAC) 616.
[98] Section 2 (f) of the Competition Act.
The South African Competition Appeal Court stated in *Anglo South Africa Capital (Pty) Ltd v Industrial Development Corporation of South Africa* [2003] 1 CPLR 10 (CAC) 20 that:
"The purpose of the Act as set out in section 2(f) is unique to the South African competition regime. Such an objective is contained in neither the United States of America Anti-trust laws nor the European Union Competition Laws. This objective seeks to incorporate in the Competition Act the constitutional principles as contained in the Constitution of the Republic of South Africa Act 108 of 1996 ("the Constitution")."

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uniqueness of some parts of South African competition law is David Lewis' observation that in South Africa "antitrust was not part of a market liberalisation agenda; it was a central feature of the democratic process."[99] Competition law in South Africa was thus "rooted in democratisation rather than liberalisation".[100] In the light of South Africa's own distinctive competition law provision, the implementation of state aid rules might be more easily achieved where the competition authorities already have to deal with matters beyond "traditional anti-trust concerns". Since the addition of state aid rules would not be the first expansion of "traditional anti-trust concerns" of South Africa's competition law, it can be accepted that these authorities are sufficiently skilled to oversee the balance between state aid and compliance with competition law.

1 2 Aid to SOEs and its contribution to failures of governance and good financial management

1 2 1 A Contextual Analysis

> "Corruption and *maladministration*[101] are inconsistent with the rule of law and the fundamental values of our Constitution. They undermine the constitutional commitment to human dignity, the achievement of equality and the advancement of human rights and freedoms. They are the antithesis of the open, accountable, democratic government required by the Constitution. If allowed to go unchecked and unpunished they will pose a serious threat to our democratic State."[102]

Two of the biggest concerns with South Africa's SOEs are financial mismanagement or irregularities[103] and the lack of proper corporate governance.[104] The "sound

[99] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 9.
[100] D Lewis *Enforcing Competition Rules in South Africa: Thieves at the Dinner Table* (2013) 11.
[101] My emphasis.
[102] *South African Association of Personal Injury Lawyers v Heath* 2001 (1) BCLR 77 (CC) 80.
[103] The many investigative reports published by the Public Protector's Office on irregularities in SOEs provide a broad impression of the many irregularities of all kinds that take place in the daily operations of SOEs. See for example the following investigative reports published by the Public Protector:
(i) "Report on and investigation into an allegation of improper conduct by the former chairperson of the board of directors of ESKOM Holdings Limited , Mr. V Moosa , relating to the awarding of a contract";

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financial governance of SOEs" which is described as a crucial measure for better fiscal management,[105] is absent in many SOEs and concerns are persistently raised about the performance and governance of SOEs. This is despite the stringent PFMA[106] which regulates governance and financial management and the recognition by the South African courts of the importance of good corporate governance in SOEs.[107] Many SOEs are not effectively managed and their management are perceived to breach basic principles of governance with impunity at least partly because they are able to rely on the financial muscle of the state.[108] Even those SOEs which were commercialised as part of South Africa's economic development initiatives such as Eskom[109] and SAA[110] still receive state aid on a regular basis. This should not be the case if the SOEs are properly governed. Hence, there can be no doubt that state support perpetuates inefficient governance and financial mismanagement, which in turn creates financial dependence of SOEs on the state.

As a result of the lack of proper corporate governance and financial mismanagement many SOEs, notwithstanding their crucial public interest mandates, have become intolerable burdens on the public purse and the wider economy. Poor governance and financial management have also caused SOEs to become threats to free and

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(ii) "A report on an investigation into allegations of maladministration, systemic corporate governance deficiencies, abuse of power and the irregular appointment of Mr. Hlaudi Motsoeneng by the South African Broadcasting Corporation (SABC)"; and
(iii) "Report on an investigation into allegations of maladministration, corruption and related improper conduct relating to the lease of the Eco Point Office Park and utilisation of labour brokers by the South African Post Office"
All reports can be accessed on (http://www.pprotect.org/library/investigation_report/investigation_report.asp)
The court cases discussed in para 1. 2 (b) of this chapter have also shown this.

[104] See A Thomas "Governance at South African state-owned enterprises: what do annual reports and the print media tell us?" (2012) 8(4) *Social Responsibility Journal* 448 448-470 for more on the poor governance within some of South Africa's SOEs.

[105] OECD *Financing State-Owned Enterprises: An Overview of National Practices* (2014) 7.

[106] See para 1.2(c) of this chapter for a discussion of the PFMA.

[107] See *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) 170 where the court stated that: "The Constitution of the Republic of South Africa, 1996 recognises the importance of good governance: Section 195 deals with basic values and principles governing public administration. In terms of this section there must be a high standard of professional ethics. In fact this standard must be promoted and maintained. These principles apply to organs of state and public enterprises. In state-owned enterprises, like other organisations, good corporate governance is ultimately about effective leadership. An organisation depends on its board to provide it with direction, and the directors need to understand what that leadership role entails."

[108] Such inference can be drawn from many of the Public Protector's reports on mismanagement and poor governance in SOEs and the case law. See note 74 above for examples of the investigative reports published by the Public Protector and par. 1.2(b) of this chapter for examples of case law dealing with this issue.

[109] The Eskom Conversion Act No 13 of 2001 converted Eskom into a public company with share capital

[110] The South African Airways Act No 5 of 2007 converted SAA into a public company with share capital.

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fair competition because the combined effect of bad financial management and poor standards of corporate governance brought about by state support contributes to competitive harm[111] to competitors of SOEs. An SOE such as SAA, for example, would long have ceased business due to its continuous financial instability,[112] in many instances caused by mismanagement, if it were a private enterprise. However, the airline only continues to operate as a firm with market dominance, because of government funding while many of its former competitors have ceased business operations.[113] Financial aid from the government is therefore "artificially improving" SAA's financial position. In a sense the airline receives perpetual "immunity from bankruptcy" through government intervention and it is not rigorously required to exercise good governance and high standards of financial management. One of SAA's competitors in a competition law matter against it noted that it is the SOE's "undisciplined commercial behaviour" which caused it continuously to experience financial troubles in turn leading to the need for further state aid.[114]

In his Budget Speech of 2018, former Finance Minister Malusi Gigaba, also alluded to the governance and operational issues in SOEs, when he stated that National Treasury, with its "limited fiscal room" cannot continue to "subsidize inefficiency".[115] The 2018 Budget Review showed that an astronomical amount of R466 billion is given to SOEs in the form of guarantees and SOEs such as SAA and the SAPO

[111] See para 1.1(c) for the harm which state aid may cause to the competitive process.
[112] SAA's financial instability became so severe that in 2014 it was removed from the oversight of the Minister of Public Enterprises and placed under the oversight of the Minister of Finance. A leading economics scholar at the University of the Witwatersrand also questions why South Africa should have a national airline which continues to burden its budget and considers SAA a major liability. See J Rossouw "South Africa must free itself form the burden of owing a national airline" *The Conversation* (17 August 2016) (can be accessed at http://theconversation.com/south-africa-must-free-itself-from-the-burden-of-owning-a-national-airline-64004)
[113] SAA's competitors included companies such as 1Time Limited, a low cost airline and Nationwide Airlines. Both however stopped doing business: 1Time stopped operations in 2012 after being placed under business rescue and eventually being liquidated and Nationwide Airlines in 2008, with Nationwide's maintenance issues of its aircrafts largely blamed for its "loss of passenger volumes" and its subsequent liquidation. See for example Justice Nicholls summary on "The rise and fall of Nationwide Airlines" in *Nationwide Airlines (Pty) Ltd (in liquidation) v South African Airways* [2016] JOL 36742 (GJ) 11-17. See also Geddes where the author states that all the benefits and privileges enjoyed by SOEs allow them to set prices below those of their competitors which are economically efficient and as a result may force their rivals out of business. See RR Geddes "Case Studies of Anticompetitive SOE Behaviour" in RR Geddes (ed) *Competing with the Government: Anticompetitive Behaviour and Public Enterprises* (2004) 27 53.
[114] *Comair Ltd v Minister of Public Enterprises* 2016 (1) SA 1 (GP) 5.
[115] Budget Speech (2018) 20
(accessible at http://www.treasury.gov.za/documents/national%20budget/2018/speech/speech.pdf).

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were also recapitalised.[116] SAA for example has a R19 billion guarantee in place while it was recapitalised with R10 billion in 2017.[117] Eskom has a R350 billion guarantee, SAA has a R19 billion guarantee and Transnet has a R3.5 billion guarantee in place.[118] The Budget Review noted that guarantees to some SOEs remain a major risk to the fiscus. It is submitted that there can be no doubt that poor financial management and governance in SOEs contribute to these guarantees and the high risk that they may be called upon.

It is therefore understandable that state funding to poorly governed SOEs has become such a highly charged and hotly debated topic in South Africa. National news headlines such as "Parastatals weigh on SA's future", "SAA[119] and the R550-million bailout", "Pension-fund bailout for Eskom", "SOEs drag SA to the state of junk"[120] and "Parastatals bailed out again-with promises of a fix" are a regular occurrence in the South African media and many of these news inserts question the continuous bailout of SOEs. This situation is or at least will become unsustainable.

The lack of proper governance, good financial management and the non- delivery by SOEs on their mandates even while being mostly state funded, also undermine how South Africans view the crucial roles of SOEs and the need for the state to support them. Hence, some have started to accept that these concerns which they have with SOEs and their funding should be addressed with privatisation. For them the privatisation[121] of SOEs has become the panacea for all governance problems. Privatisation has for instance been touted by the South African Institute of Race

[116] Budget Review (2018) 91
(accessible at http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf).
[117] See the media statement issued on the recapitalisation of SAA
(http://www.treasury.gov.za/comm_media/press/2017/2017070101%20SAA%20recapitalisation.pdf).
[118] Budget Review (2018) 90-91
(accessible at http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf).
[119] Even the courts have noticed the public scrutiny which SAA as a SOE has been subjected to. Justice Sutherland in *South African Airways SOC v BDFM Publishers (Pty) Ltd* 2016 (2) SA 561 (GJ) 565 said "SAA is a public company and an organ of state whose financial affairs have been the subject of intense public interest and media scrutiny for several years, in which its viability as a going concern has been the main theme together with the financial support given to it by the state."
[120] See the Financial Week (29 September 2016).
[121] For more on privatisation in South Africa see E Goosen *The Future of Rail Transport in South Africa in a Deregulated Transport Environment* MEcon Stellenbosch (1997) 16-22.

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Relations (IRR) as the "only viable option for struggling SOEs"[122] and the "key to real economic transformation".[123]

Privatisation is one solution to solve the governance problems in SOEs as well as the problems surrounding the financing of SOEs. It is however not always the ideal option. Firstly, since so many of South Africa's SOEs have public interest roles, privatisation may obstruct the achievement of socio-economic goals set by the government. Secondly, privatisation may only work if the government puts strict regulation in place in order to prevent those SOEs from becoming privately-owned monopolies[124] since SOEs in a number of sectors such as public utilities, railways and postal services are state monopolies.[125] They are monopolies either because there are no competitors in the sector because of significant barriers to enter the sector or because of subsidization from the government. Regardless whether SOEs are loss-making entities, state aid allows them to remain dominant entities in their sectors. Hence, government monopolies are found in sectors which the government considers strategic or where the government considers it necessary to provide such services and goods to South Africans itself.

What transpired after the privatisation of Iscor serves as an example of how a government owned monopoly can become a privately owned monopoly. Iscor,[126]

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[122] J Kane-Berman "Privatisation or Bust" (2016) 27(4) *Liberty: The Policy Bulletin of the IRR* 1-33

[123] See L Sharp "Privatisation is key to real economic transformation" *Business Day* (11 September 2014).

[124] In this regard reference can be made to the privatisation of Sasol. It was privatised in three tranches: Sasol Limited, the holding company, was privatised in 1979, Sasol II followed in 1983 and Sasol III followed in 1991. See RB Horwitz Communication and Democratic Reform in South Africa (2004) 114. Notwithstanding its privatisation Sasol still enjoyed elevated treatment by the government because of its "special strategic status" and the government continued to provide state support, which only ended after Apartheid. This in essence ensured that Sasol continued to have a monopoly in its market, however not as an SOE but as a privately-owned enterprise. See S Sparks "Between 'Artificial Economics' and the 'Discipline of the Market': Sasol from Parastatal to Privatisation" (2016) 42(4) *Journal of Southern African Studies* 711 723.

[125] Current state monopolies include, for example, Eskom which has monopoly power over electricity supply in South Africa and Transnet, with its diversified operations which have monopolies in port management, railway and pipeline operations. Eskom's monopoly power is fully describe by the following quote: "In South Africa we have several examples of monopolies. Perhaps the best known example is Eskom. If you want electricity in your house or community, you can't go to a number of suppliers and asked to be connected. You must either ask Eskom or do without electricity." See J Pape *Economics: An Introduction for South African Learners* (2000) 22. By describing themselves as the "custodian of rail, ports and pipelines" in South Africa, Transnet's monopoly is clear. See https://www.transnet.net/Divisions/Pages/DivisionsHome.aspx (accessed on 12 January 2016).

[126] Iscor is now known as Mittalsteel South Africa Limited, an "iron and steel manufacturing company". Mittal SA is South Africa's biggest steel producer and is the primary producer of certain steel products. See *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) See also *Mittalsteel SA Ltd (previously known as Iscor Ltd) v Hlatshwayo* [2006] JOL 18184 (SCA).

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once described by the Competition Tribunal of South Africa (the Tribunal) as an "uncontested firm within an incontestable market", was privatised and incorporated as a privately owned company in terms of the Companies Act 61 of 1973 in 1989. The Tribunal described how Iscor continued its "passage from inefficient state owned enterprise to profit maximising monopolist".[127] It also noted that "shortly after its [Iscor's] privatization, a state owned monopoly had effectively been transformed into a privately owned and unregulated monopoly".[128] Iscor (today known as Mittal SA) became a "privately owned and unregulated monopoly" within its monopolised domestic market and it had the ability to exploit "its structural power by reducing output in order to increase price" and it did so by removing "excess" output from the domestic market".[129] This highlights that the privatisation of Iscor might not have been the best option at the time. It is not unreasonable to believe that the South African government has learned some valuable lessons from the privatisation of SOEs such as Iscor and Sasol. It would therefore not be unreasonable to argue that the government has reason to be wary of privatisation as the only option to solve the woes caused by SOEs.[130] Furthermore, trade unions such as COSATU[131] also note their reasons for continuously objecting to any privatisation of SOEs. They believe that privatisation may lead to:

(i) a deterioration of service, especially to the poorest communities, as the ethos of public service is replaced by pursuit of quick profits;

(ii) job losses, as the new private owners try to cut their costs and extract as much labour from as few workers as possible;

(iii) widening the already massive inequality in the distribution of wealth, as the new owners enrich themselves, and bring no benefits to the majority of the people;

(v) limiting the ability of government to intervene to achieve social objectives, including job creation, better service delivery and protection of the environment.

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[127] See *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) para 126.

[128] See the statement by the Competition Tribunal in *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) para 126.

[129] *Harmony Gold Mining Company Ltd v Mittal Steel South Africa Ltd* [2007] 1 CPLR 37 (CT) para 166.

[130] Organisations such as COSATU, the South African Communist Party (SACP) and the now defunct Anti-Privatisation Forum (APF) undoubtedly contributed to this wariness. For more on the APF see D McKinley "Lessons in community-based resistance? South Africa's Anti-Privatisation Forum" (2016) 34(2) *Journal of Contemporary African Studies* 268-281.

[131] See http://www.cosatu.org.za/show.php?ID=749 (last visited on 4 April 2019).

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As a consequence options other than privatisation need to be explored to ensure that SOEs become more efficient, improve operational performance and remain competitive. The regulation of state aid to SOEs is therefore one such option to explore.

In conclusion, a number of observations can be made with regard to the poor governance and financial management of SOEs.
Firstly, there can be no doubt that when financial maladministration and poor governance within SOEs are rooted out, these entities will become more attractive for investment and other funding outside of government and at the same time they may become more self-reliant. This will remove the burden from the public purse.

Secondly, directly related to effective financial management and good governance of SOEs, is how the state funding is ultimately spent by those in charge of the SOEs. When those in charge of SOEs are aware that the way in which state funding is spent may be scrutinised, they would perhaps make greater efforts to ensure that funds are used in ways which are in line with the PFMA and for those purposes which the funds were meant for. Although billions of rand are annually spent on SOEs, many SOEs are struggling to fully meet their developmental mandates. Millions of South Africans still do not benefit from services which are supposed to be delivered by SOEs. Firstly, services such as water and sanitation are often not available to the poorest South Africans, secondly, public transport operated by PRASA which is mostly used by poor South Africans does not function as it should and thirdly, electricity distribution and supply is not always guaranteed as illustrated by the recent “load shedding” crisis. The South African government even recently had to sell its shareholding in Vodacom, one of South Africa’s leading mobile networks, to obtain funds to assist Eskom which had struggled to provide South Africa with the necessary electricity supply and thus comply with its mandate.[132] These are all indications that SOEs, notwithstanding the state funds which they receive, do not meet their respective mandates. There is no doubt poor governance is a major contributor to non-delivery on mandates. Corporate governance failures

[132] For more on this see http://www.fin24.com/Economy/Eskom/Govt-sells-Vodacom-stake-to-fund-Eskom-20150701 (visited on 11 July 2015).

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often mean that public funds have to be made available to cover commercial losses and that public funds received from the National Treasury by SOEs are not spent on public mandates only. A principle of public funds for public mandates could ensure significant savings for the National Treasury since it will not have to fork out additional billions of rand for SOEs to allow them to conduct commercial activities. This however, can only be achieved if both the governance and financial management of the SOEs are in order.

All monies that are saved because SOEs are properly managed and state funding is spent as it should be could be invested in socio-economic programmes or will not have to be borrowed. In the long term it is untenable that the government applies funds which could be used for other socio-economic programmes, to provide continuous unlimited state aid to poorly governed SOEs to allow them to perform or at least also perform commercial activities. It is submitted that limited state resources should not be used to allow SOEs to conduct commercial activities in the absence of good governance and financial management as well as compliance with the SOE's mandate. The government should be able to rely on SOEs to generate income on their commercial activities and not the other way round and this is possible if the SOEs are governed in ways set out in South Africa's regulatory framework on corporate governance and financial management. In *Johannesburg Housing Corporation (Pty) Ltd v Unlawful Occupiers of the Newtown Urban Village,*[133] Judge Willis made the following statement in regard to the limited availability of funds to the state for realising socio-economic demands:

> "Anywhere in the world, when it comes to funding programmes for socio-economic development, the state has only three levers which it can pull: profits from state enterprises, taxation or debt."[134]

[133] 2013 (3) BCLR 337 (GSJ) para 104.
[134] *Johannesburg Housing Corporation (Pty) Ltd v Unlawful Occupiers of the Newtown Urban Village* 2013 (3) BCLR 337 (GSJ) para 104. Although this comment was made in the context of the case, it does not detract from the fact that SOE should be for the government a source of income, while in South Africa, government is on many occasions a source of income for the SOEs.

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It is submitted that the South African government's reliance on "profits from state enterprises", as indicated by Judge Willis, remains a distant reality because at present poorly governed SOEs rely on the government for funding instead of the government relying on them for profits.

Lastly, effective governance and proper financial management may help South Africans to understand that not all SOEs should be targets for privatisation because of their crucial mandates.

1 2 2 Examples from the case law of governance failures of SOEs that are still receiving state aid

Regardless of all the debate, public outrage, the robust PFMA and the recognition by the courts of the role of proper governance of SOEs, financial irregularities and poor governance within SOEs continue unabated as shown by various court cases in the recent past against the management of SOEs. Even poor and undisciplined management of SOEs, which turns them into financial burdens on the National Treasury, often does not appear to disqualify them from being granted wide-ranging further financial assistance, because of the frequent political connections of those managers and the public interest mandates of the enterprises.

An example of this is the case of SAA which in 2011 sued Khaya Ngqula ("Ngqula"), its former Chief Executive Officer ("CEO") for the sum of R26,581,794.77. SAA alleged that this claim arose because of a breach of fiduciary duties by Ngqula.[135] SAA also sued Ngqula for the rand equivalent of US $3,400,000.00 which arose from a sponsorship agreement with an Argentine golfer as it argued that Ngqula had no authorisation to spend such an amount on sponsorships and R229,170.00 for unauthorised expenses by Ngqula.[136] This behaviour was considered to be in conflict with section 66 of the PFMA which places restrictions on the borrowing of money,

[135] See *South African Airways (Pty) Ltd v Ngqula* 2011 JDR 1305 (GSJ).
[136] See *South African Airways (Pty) Ltd v Ngqula* 2011 JDR 1305 (GSJ) para 2.

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the issue of guarantees or any other commitment that binds the public entity or the Revenue Fund.[137]

In September 2009 at Transnet Freight Rail, a division of Transnet, Gama who was the CEO at the time, was suspended and a disciplinary process was started against him due to serious allegations regarding maladministration in respect of two contracts which were awarded under his supervision.[138] One contract concerned a tender process regarding fifty locomotives and the second contract concerned the procurement of security services from a company called General Nyanda Security Risk Advisory Services (Pty) Limited (GNS).[139] In regard to the locomotive contract it was alleged that Gama concluded the contract in disregard of a condition by the Transnet Board that another division of Transnet namely Transnet Rail Engineering should carry out all engineering on the assembly and maintenance of the locomotives. It was stated that Gama's failure to adhere to this condition led to serious financial consequences for Transnet.[140] In regard to the contract with General Nyanda Security Risk Advisory Services (Pty) Limited (GNS), it was stated by Transnet that Mr Gama concluded the contract without following a tender process and without having the authority to enter into the contract as Gama's authority to enter into such a type of contract was said to be limited to a value of R10 million, while the total estimated value of the contract was close to R19 million and subsequent spending on the contract amounted to some R55 million.[141]

Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited[142] is another case which showed how mismanagement may affect the

[137] Section 66 of the PFMA provides that: "(1) An institution to which this Act applies may not borrow money or issue a guarantee, indemnity or security, or enter into any other transaction that binds or may bind that institution or the Revenue Fund to any future financial commitment, unless such borrowing, guarantee, indemnity, security or other transaction—
(*a*) is authorised by this Act; and
(*b*) in the case of public entities, is also authorised by other legislation not in conflict with this Act; and
(*c*) in the case of loans by a province or a provincial government business enterprise under the ownership control of a provincial executive, is within the limits as set in terms of the Borrowing Powers of Provincial Governments Act 1996(Act No. 48 of 1996)."
[138] *Gama v Transnet Limited* 2010 JDR 0059 (GSJ).
[139] *Gama v Transnet Limited* 2010 JDR 0059 (GSJ) para 9.
[140] *Gama v Transnet Limited* 2010 JDR 0059 (GSJ) para 10.
[141] *Gama v Transnet Limited* 2010 JDR 0059 (GSJ) para 11.
[142] 2015 (6) SA 338 (WCC).

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finances of an SOE. Mthimunye- Bakoro was the chief financial officer of Petroleum Oil and Gas Corporation of South Africa (PetroSA) at the time when a substantial loss of billions of rand was reported for the financial year ending March 2015. The board initiated an investigation to determine the cause of the losses and also the poor performance of Mthimunye-Bakoro. It came to the conclusion that the poor financial performance could be attributed partly to Mthimunye-Bakoro's conduct as she was in charge of the SOE's financial affairs and that the financial health of the SOE fell within Mthimunye-Bakoro's duties and responsibilities as the group chief financial officer. The board also concluded that Mthimunye-Bakoro had committed acts of serious misconduct and possible contraventions of the PFMA.

1 2 3 The PFMA's limited ability to address financial management concerns with SOEs

An analysis of financial management and SOEs is incomplete without some brief comments about the PFMA. The PFMA[143] transformed the way public money is spent in South Africa. It is meant to ensure proper and transparent financial management of SOEs. While the PFMA governs the financial management of SOEs, statutes such as the enabling legislation[144] of SOEs and to a certain extent some other general legislation which include the Companies Act and the Competition Act govern their general operation.

Schedules one, two and three of the PFMA list all those institutions to which the Act apply and the categories into which they fall.[145] Schedule one lists the constitutional institutions, which, inter alia, include the Commission for Gender Equality, the Human Rights Commission, the Independent Electoral Commission of South Africa and the Public Protector.

Schedule two lists the major public entities which include SOEs such as SAA, Telkom and Broadband Infraco Limited, all of which are commercialised SOEs. All

[143] See also the discussion on the PFMA in para 3.6 of chapter 2.
[144] The South African Post Office SOC Limited Act 22 of 2011; South African Airways Act 5 of 2007; and Armaments Corporation of South Africa Limited Act 51 of 2003 are all enabling legislation of SOEs.
[145] See Schedules two and three of the PFMA.

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provisions of the Companies Act 71 of 2008 which apply to public companies, apply to the commercialised SOEs which are registered as such in terms of the Companies Act. However, in terms of section 9 of the Act the member of the Cabinet responsible for the SOE may request a total, partial or conditional exemption from one or more provisions of the Act. The applicability of provisions of the Companies Act to SOEs was discussed and decided on in *Minister of Defence and Military Veterans v Motau*.[146] The Constitutional Court had to decide on the applicability of section 71(1) and (2) of the Companies Act to the removal of board members of an SOE, which in this case was Armscor. The court said that the effect of section 9 of the Companies Act is that "state-owned companies are for all intents and purposes to be treated as public companies unless a cabinet member has procured an exemption (in whole or in part) from the obligation to comply with the Companies Act."[147] The court decided that the Minister in this case did not apply for an exemption from the provisions of the Companies Act and as a result she was bound by Article 71(1) and (2) when she wished to remove board members. Furthermore, the Minister did not take those steps required by the Companies Act when she dismissed the two relevant board members in this case. Hence, she failed to observe the provisions of the Companies Act and therefore acted unlawful.

Steenkamp v Central Energy Fund SOC Ltd[148] and *SOS Support Public Broadcasting Coalition v South African Broadcasting Corporation SOC Limited*[149] also dealt with the applicability of the provisions of the Companies Act to SOEs. The two provincial High Courts[150] however followed different approaches to the application of the provisions of the Companies Act to SOEs. In *Steenkamp* the removal of board members of PetroSA was the issue at hand. The Central Energy Fund SOC Ltd (the CEF), the holding company of PetroSA of which the Minister of Energy, the political head of the Department of Energy, is the sole shareholder

[146] 2014 (5) SA 69 (CC).
[147] *Minister of Defence and Military Veterans v Motau* 2014 (5) SA 69 (CC) para 73.
[148] 2018 (1) SA 311 (WCC).
[149] (81056/14) [2017] ZAGPJHC 289 (17 October 2017)
[150] The Western Cape division and the Gauteng (South Gauteng) division.

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recommended the removal of two directors of PetroSA for a number of reasons.[151] The two former directors approached the court and contended that they were unlawfully removed as directors since the CEF failed to comply with the relevant provisions of the Companies Act. The court decided that there was compliance with the provisions of the Companies Act. Hence, the removal of the two board members was valid. *SOS Support Public Broadcasting Coalition* concerned the constitutionality and lawfulness of the powers that the Minister of Communications exercises in respect of the directors of the SABC Board including the power of the minister to remove any of the directors (including non-executive directors). One of the issues which the court had to determine was whether section 71 of the Companies Act may be applied to the removal of directors of the SABC or whether the procedures under sections 15 and 15A of the Broadcasting Act 4 of 1999 (the Broadcasting Act) must be followed. Three non-executive directors of the SABC were removed without due regard to the provisions of section 15 of the Broadcasting Act. The applicants in the matter argued that the removals were unlawful for non-compliance with the special provisions governing the removal of SABC directors under sections 15 and 15A of the Broadcasting Act. Hence, a declaratory order was sought to state that members of the SABC board may not be removed save in compliance with sections 15(1) and (2) and 15A of the Broadcasting Act. The court looked at both the procedures for the removal of directors provided in terms of section 15 of the Broadcasting Act and section 71 of the Companies Act and declared that members of the SABC Board may not be removed safe in compliance with sections 15(1) and (2) of the Broadcasting Act. Its findings, inter alia, included:

(i) that sections 15 and 15A of the Broadcasting Act ensure that there is a level of oversight in the removal of a director of the SABC Board and that neither the Minister of Communications nor the SABC Board can remove a director unilaterally.

(ii) that removal requires an inquiry and must be based on specified and objective grounds for removal and where the National Assembly recommends removal, the President has no discretion and must remove the director from office.

(iii) that section 71 of the Companies Act, on the other hand, empowers firstly, the Minister of Communications to remove any member of the Board, for any reason,

[151] These include that the failure to communicate reasons for losses suffered by the SOE, failure to meet agreed financial targets which were critical for the continued operational capacity of PetroSA and plans to turn around PetroSA's performance to stem losses.

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subject only to the requirement of notice under section 71(2). Secondly, the Board is empowered to remove any member of the Board, among other things, for negligence or dereliction of duty by a simple majority, subject only to the requirement of notice and comment under section 71(4).

(iv) that the removal provisions of the Companies Act cannot be construed as applying to the SABC because the Broadcasting Act prevails over the Companies Act as it was specifically enacted to govern the operations of the SABC.

(v) that the removal processes prescribed under the Companies Act denies members of the SABC Board security of tenure and thus undermines the independence of the SABC Board in a manner that is inconsistent with the Constitution.

(vi) that the Broadcasting Act is the specific legislation enacted by Parliament in respect of the national public service broadcaster, with the broadcasting services to be "owned and controlled by South Africans".

(vii) by permitting the removal of board members unilaterally at the instance of the Minister of Communications as sole shareholder and removal by simple majority vote of the Board, section 71 of the Companies Act undermines their independence. The threat of removal without any oversight, on any ground, and without due enquiry, would render SABC Board members not likely to express views not aligned with that of the government or the majority Board members.

(vii) although section 5(4)(b)(i) of the Companies Act provides for specific statutes and provisions in other statutes to prevail in the event of inconsistency with the provisions of the Companies Act, the Broadcasting Act is not listed under that provision and accordingly none of the provisions of the Broadcasting Act is made applicable in the event of inconsistency with the Companies Act. Since this goes against section 7(2) and 16 of the Constitution, the relevant provisions of the Companies Act are invalid to this extent.

It is clear that the court's approach in *SOS Support Public Broadcasting Coalition* on the application of the provisions of the Companies Act to the removal of directors on the board of the SABC came as a result of the existence of a special procedure for the removal of directors in the Broadcasting Act. It affirms that should there be a conflict between provisions in the Companies Act which are applicable to SOEs and provisions in the SOEs' enabling legislation which regulate the same matter, in this

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case the removal of directors, the provisions in the SOEs enabling legislation will trump those in the Companies Act. This may be the position even if no exemption, total, partial or conditional, is in place in regard to the application of the provisions of the Companies Act to SOEs.[152] It is possible that the court in *Steenkamp* might have followed the same approach as in *SOS Support Public Broadcasting Coalition*, if a special procedure for the removal of directors existed in the enabling legislation which governs PetroSA.

Schedule three lists other national public entities such as those entities which are purely governmental agencies and do not operate as business enterprises but instead deliver recognised services such as Legal Aid South Africa, the Financial Intelligence Centre and the National Credit Regulator. Schedule three also lists those SOEs which in accordance with the Act are classified as "national government business enterprises". These entities provide goods and services in accordance with ordinary business principles and include entities such as the Public Investment Corporation Limited, PRASA and Sentech.

The PFMA puts a number of strict requirements in place to ensure the protection of public money and provides significant boundaries on how, when and for what purposes public funds can be used. These include (i) that every public entity must have an authority which must be accountable for purposes of the PFMA,[153] (ii) disciplinary proceedings and even criminal proceedings against accounting authorities and officials of SOEs in cases of financial misconduct,[154] (iii) the submission of an annual budget and corporate plan by government business enterprises and those entities listed in Schedule two of the PFMA,[155] and (iv) the power of the National Treasury to intervene when there is a "serious or persistent material breach" of the PFMA by any institution to which the PFMA applies, which

[152] Section 9(2) and 3 of the Companies Act 71 of 2008 allows the member of Cabinet which is responsible for an SOE to apply for a partial, total of conditional exemption from one or more of the provisions of that Act. Such exemptions are granted by the Minister of Trade and Industry in a Government Gazette after the Minister has received advice in this regard from the Companies and Intellectual Property Commission (CIPC).
[153] Section 9 of the PFMA.
[154] Sections 81 to 86 of the PFMA.
[155] Section 52 of the PFMA.

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may lead to the withholding of funds in terms of section 216 (2) of the Constitution.[156] These are all powerful measures to ensure the protection of public money and to root out any financial mismanagement of SOEs.

However, those in charge of SOEs continue to contravene the provisions of the PFMA regularly. Contraventions happen within a number of SOEs such as PetroSA,[157] SAA,[158] PRASA,[159] SAPO[160] and the SABC.[161] Consequently SOEs continue to be dependent on government funding.

It is thus apparent[162] that even the powerful provisions of the PFMA and stringent corporate governance rules and principles[163] are not enough to deter the

[156] Section 6 (2) (f) of the PFMA.
[157] See *Mthimunye- Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd* 2015 (6) SA 338 (WCC) para 9.
[158] SAA stated for example in their "South African Airways Group Integrated Annual Report " of 2014, page 79 the following on non-compliance with the PFMA: "In an effort to further reduce PFMA non-compliance within SAA, management has developed and implemented action plans that will see a significant reduction to PFMA non-compliance in the coming financial year. The focus of these plans is to ensure that there is consequence management in place and improved processes."
(available at https://www.flysaa.com/eg/en/.../Financials/SAA_Front_section_copy.pdf). In one of their most recent annual report, the "South African Airways Group Integrated Annual Report for the Year Ended 2016" 67, SAA stated the following on non-compliance with the PFMA: "The organisation will continuously review and update interactions that will assist the organisation to further reduce the PFMA non-compliance. Some of the interactions that are currently being monitored are: Review of the contract management department. The optimal structure will assist the organisation in ensuring contract management process is effective and efficient to discharge the cost effective, transparent and fair objectives of procurement process. • Review the control measures such as disciplinary process, to ensure consistent enforcement within the organisation." (available at https://www.flysaa.com/hu/en/Documents/Financials/SAA_IAR_2016.pdf).
[159] See the Public Protector Report titled "Derailed: A report on an investigation into allegations of maladministration relating to financial mismanagement, tender irregularities and appointment irregularities against the Passenger Rail Agency of South Africa (PRASA)" Report No 3 of 2015/16 (available at http://www.pprotect.org/library/investigation_report/2015-16/PRASA_FINAL_28_August_2015.pdf).
[160] See the Public Protector Report "Postpone Delivery: Report on an investigation into allegations of maladministration , corruption and related improper conduct relating to the leasing of the Eco Point Office Park and utilisation of labour brokers by the South African Post Office" Report No 5 of 2105/16 (available at http://www.pprotect.org/library/investigation_report/2015-16/SAPO%20REPORT%20Postponed%20Delivery.pdf).
[161] For allegations and findings of various irregularities, including financial irregularities, within the SABC see for example *South African Broadcasting Corporation v Avusa Ltd* 2010 (1) SA 280 (GSJ); *South African Broadcasting Corporation Soc Ltd v Democratic Alliance* 2016 (2) SA 522 (SCA); the Public Protector Report "A report on an investigation into allegations of maladministration, systemic corporate governance deficiencies, abuse of power and the irregular appointment of Mr. Hlaudi Motsoeneng by the South African Broadcasting Corporation (SABC)" Report No 23 of 2013/2014 (http://www.pprotect.org/library/investigation_report/2013-14/SABC%20FINAL%20REPORT%2017%20FEBRUARY%202014.pdf) and the recent case *Democratic Alliance v South African Broadcasting Corporation SOC Ltd (SABC); Democratic Alliance v Motsoeneng* [2017] 2 BLLR 153 (WCC).
[162] See the examples of the non-compliance with the PFMA in footnotes 119- 123 in para 1.2 (c) of this chapter.
[163] Described by Justice Davis as the "animating idea of which is to ensure net gains in wealth for shareholders, protect the legitimate concerns of other stakeholders and improve efficiency, organisational performance and

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management of certain SOEs from repetitive engagements in widespread financial mismanagement. Although the PFMA already came into effect eighteen years ago, we still see a situation in South Africa where SOEs too often require government financial intervention because of governance failures or improper financial management. This shows that there are gaps that need to be filled to promote good governance and financial management that would ensure that SOEs are able to function without the need for continual government funding.

1 2 4 Could state aid rules guided by EU-state aid rules fill some of the regulatory gaps left by existing legislation that concern governance and financial management?

Discontent over when and how financial aid by the government to troublesome SOEs should be granted, had reached such an alarming level that the ANC-led government saw the need to establish a Presidential Review Committee on State-Owned Enterprises (the Committee) in May 2010. The Committee submitted its final report[164] in which it made thirty one crucial recommendations on the way forward. The recommendations, inter alia, include (i) the enactment of a "single overarching law" to govern all SOEs, (ii) a framework for the appointment of SOE boards and CEO's, (iii) a framework for collaboration among SOEs, (iv) a central remuneration authority; (vi) a consolidated funding model for commercial SOEs; and (vii) that the government address the issue of commercial SOEs that are not financially viable.[165] The implementation timeframe for the recommendations stretches from 2012 until 2025. While the recommended Presidential State-Owned Enterprises Coordinating Council has been established,[166] it remains to be seen how many of the other recommendations will be implemented in accordance with the time frame suggested by the Committee. It is submitted that the government should pursue timeous

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resource allocation" through a number of duties and responsibilities placed upon directors. See *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* 2015 (6) SA 338 (WCC) 1.

[164] The report can be accessed on http://www.thepresidency.gov.za/electronicreport/index.html.

[165] For more on the recommendations made see also M Mbo *Drivers of Organisational Performance: A State Owned Enterprise Perspective* Doctor of Business Management and Administration Stellenbosch (2017).

[166] See http://www.presidency.gov.za/content/presidential-soe-coordinating-council-arises-presidential-soe-review-committee-and-not-new.

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implementation of the recommendations within the suggested implementation phase, especially if it will address the poor governance and financial management of SOEs.

While acknowledging both the efforts by the government to correct what is currently wrong with the governance and the financial management of SOEs and the strict requirements in regard to financial management stated in the PFMA, the fact that poor financial management and governance are still the order of the day in many SOEs, shows that there are gaps that need to be filled. Hence, it is proposed that the implementation of state aid control rules may fill some of the gaps and supplement the PFMA. Examples of how state aid control rules could help to do this include:
(i) State aid rules may assist in ensuring improved governance and financial management and if these are adhere to, it will most likely remove the need for regular financial assistance, which will have a significant positive impact on the availability of public funds.
(ii) State aid rules will most likely also ensure that the state funding will be utilised for those purposes for which it was granted.

Although state aid rules may not be the complete solution for aid that perpetuates an uneven playing field between SOEs and their private competitors and regularly threatens free and fair competition, it will certainly bolster the regime by which SOEs are regulated. This is especially since the examination of the EU state aid control rules[167] has shown a number of characteristics that could help to address the problem of reconciling the financing of SOEs in South Africa with other pursuits such as free and fair competition and proper governance which ensure financial independence. These characteristics include (i) that state aid to public undertakings (SOEs in South Africa) can be controlled without necessarily having a negative impact on the execution of the undertakings' public mandates; (ii) the EU state aid control regime is able to distinguish between the situation where firms should be independent and self-sustained and when state aid to firms is necessary; and (iii) that governments are still able to provide state aid if such aid would serve a general

[167] Chapter 4 of this study has provided a comprehensive scrutiny of state aid rules within the EU and how these rules are used to prevent the distortion of competition.

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public interest[168] and if the procedural rules of the state aid regulatory framework are complied with.

A former chairman of Eskom, Reuel Khoza, correctly contended that: "State-owned corporations in a transforming South Africa can, in fact, set an example of what a corporation should be."[169] However, at the current trajectory, SOEs in South Africa rather set an example of what corporations should not be, with widespread financial mismanagement, cronyism, corruption and nepotism. Hence, it is submitted that state aid rules influenced by the EU state aid rules may lead to better financial management and corporate governance of SOEs. State aid rules will also ensure that state aid is not considered to be the easy way out after mismanagement of SOEs, but that it is really the last resort in instances where the demise of the SOE not only threatens the South African economy but will also impact on South Africa's overall "developmental and national needs".

2 The difficulties with the application of state aid rules in South Africa

Even though the state aid control model of the EU is regarded by this study as a yardstick for state financing of SOEs in South Africa, it is acknowledged that the regulation of state aid will have to be adapted for South Africa and could be more difficult in this jurisdiction. Certain country-specific[170] factors may make it difficult to implement state aid rules in South Africa. The obstacles to applying state aid rules in South Africa and possible ways in which they can be overcome must therefore be set out.

[168] See in this regard for example the provision in article 106(2) of the TFEU.
[169] MP Mangaliso & ST Nkomo "Eskom's Chairman Reuel Khoza on the transformation of South African business" (2001) 15(3) *Academy of Management Executive* 8 8.
[170] See in this regard, for example, DR Hazel "Competition in Context: The Limitations of Using Competition Law as a Vehicle for Social Policy in the Developing World" (2015) 37(2) *Houston Journal of International Law* 312 299 where the author discusses the influence which a country's history and cultural conditions may have on its competition policies.

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2 1 The public interest function of South African SOEs

It is acknowledged throughout this study that SOEs should play a significant role in South Africa's development process.[171] In justifying its decisions to provide working capital to SAA in 2018 government emphasised the creation of an efficient enterprise but also that this SOE had to be enabled to allow it to serve the "developmental agenda".[172] Accordingly, there should be limits to the application of competition law to SOEs and their activities. The answer for such limitation lies in the reasons for the existence of the SOEs. There are many reasons for governments operating SOEs[173] and many SOEs do not necessarily exist for profit maximization but are required to pursue other goals. Koch lists a number of reasons for governments to be involved in the economy. These include (i) the provision of safety and security; (ii) support for public health, education and research; and (iii) the provision of water, sanitation, communications, energy and transportation infrastructure.[174] Other reasons for conducting businesses as SOEs include pride or that the enterprise started out as an SOE and the government wants the status quo to remain. [175]

In South Africa the government uses SOEs as instruments to achieve many of its socio-economic goals. SOEs are considered to be an "administrative device" used by the government to execute some of its responsibilities to its citizens. Gcabashe states that SOEs "provide the state with the means to direct investment in order to redress the past imbalances and to create the infrastructure required to stimulate

[171] For more on the developmental role of SOEs in South Africa see OECD *State-Owned Enterprises in the Development Process* (2015) (at http://dx.doi.org/10.1787/9789264229617-en).
[172] Five strategic objections forms part of the long-tern turnaround strategy and include (i) support for South Africa's development agenda; (ii) achieve and maintain financial stability; (iii) provide excellent customer service; (iv) consistent, efficient and effective operations; and (v) performance excellence. See South African Airways Group Integrated Report for the year ended 31 March 2017 41
(available at https://www.flysaa.com/documents/51855150/0/SAA_IAR+2017.pdf/22db54be-b1f5-404a-99fd-d12f3fe9e56b).
[173] See para 1.2 of chapter 2 for a comprehensive discussion on the reasons for the continuous use of SOEs by governments.
[174] S Koch "The secret to successful state-owned enterprises is how they're run" *The Conversation* (22 January 2016)
(Accessible at http://theconversation.com/thesecrettosuccessfulstateownedenterprisesishowtheyrerun53118).
[175] M Gulati & D Skeel "How to Get the Government-Owned Corporation Working" (2001) 36(48) *Economic and Political Weekly* 4460 4460.

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economic growth".[176] The government has to promote two important goals. On the one hand it needs to ensure sustainable economic growth and on the other hand it has to work to alleviate poverty. Present socio-economic conditions in South Africa make it appear as if these two goals are irreconcilable. However, Rodick correctly observes that "historically nothing worked better than economic growth to enabling societies to improve the life chances of their members, including those at the very bottom".[177] If the ANC-led government can ensure sustainable economic growth through its policies and if Rodick's observation on the impact of economic growth on "life chances" historically is anything to go by, economic growth is certain to have a direct positive impact on poverty levels in South Africa. The only uncertainty therefore is the degree to which it will improve "life chances" for the poor people of South Africa.

It is acknowledged that the existence of SOEs in certain sectors help with the development of the economy since SOEs, inter alia, assist with infrastructure development. They are frequently responsible for maintaining networks and provide service such as power, roads, transport, water, communications, which the rest of the South African economy depends on.[178] These enterprises are some of the biggest employers in South Africa, thus having a positive impact on the high unemployment rate. SOEs may make it possible for previously disadvantaged people to become owners in enterprises as the State may use SOEs to spread ownership to historically disadvantage people. It may do so by selling some of its interest in SOEs to historically disadvantaged persons through a public offer. In this instance special purpose companies may be used and the shares may be offered to the historically disadvantage people for a minimal share price, just like the government did in regard to Telkom in 2003.[179] Consequently, SOEs may help to achieve some of the broader goals stated in the Competition Act.[180]

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[176] RJ Khoza & M Adam *The Power of Governance: Enhancing the Performance of State-Owned Enterprises* (2007) vii.
[177] D Rodick *One Economics, Many Recipes: Globalization, Institutions and Economic Growth* (2007) 2.
[178] This was noted by former Minister of Finance, Pravin Gordhan in his 2016 Budget Speech (accessible at http://www.treasury.gov.za/documents/national%20budget/2016/speech/speech.pdf).
[179] In 2003 the South African government offered discounted shares in Telkom to historically disadvantaged people through a public offering. Each applicant was entitled to acquire shares of up R 5 000.00. See "Deals of the Year 2003" (2004) 15(3) *International Tax Review* 11 11-17. See also the media statement in this regard

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Due to the exclusion of the majority of South Africans from basic services in the past, it is not difficult to understand why the State prefers to deliver certain goods and services itself, instead of leaving it to the private sector. Services such as postal services as well as electricity generation and distribution need to reach every South African. After nearly twenty five years of democracy, the governmental endeavours to reduce poverty and to ensure sustainable economic development for all, has only borne limited fruit. South Africans therefore expect the government to be pro-active in improving lives. Hence, the government uses SOEs to (i) ensure that the required essential services reach every South African, (ii) fight poverty and inequality, (iii) create jobs; and (iv) develop infrastructure. SOEs are therefore well established enterprises within the South African economy. This was the position even before the dawn of democracy in South Africa.[181] To this extent Carrick is correct when he states that the government's involvement in the market is not always disastrous and government's bad reputation as a producer may be undeserved.[182] This study therefore agrees with Sokol[183] when the author states that governments may even restrain competition for "welfare-enhancing reasons".

It is also reassuring to know that the notion that SOEs are essential economic players is not unique to South Africa. SOEs once also formed an essential part of the economies of countries which are today known as developed countries.[184] Substantial financing of SOEs is also not unique to South Africa. OECD member countries, which include mostly the developed countries, also have "national practices" in place to finance SOEs. The OECD recognised the role which SOEs can play in a country's economy when it stated that:

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which was issued by the Department of Public Enterprises at http://www.dpe.gov.za/newsroom/Pages/Telkom-share-offer-is-not-discriminatory.aspx.

[180] See the discussion on the goals of the Competition Act in para 4.3.8 of chapter 3.

[181] See para 3.3 of chapter 2 for a comprehensive discussion of prominent South African SOEs before and after the dawn of democracy.

[182] PM Carrick "New Evidence on Government Efficiency" (1988) 7(3) *Journal of Policy Analysis and Management* 518 518.

[183] D Sokol "Anticompetitive Government Regulation" in DD Sokol & I Lianos (eds) *The Global Limits of Competition Law* (2012) 83 84.

[184] See para 2 of chapter 2 for the discussion on SOEs in France, Britain and Germany.

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> "State-owned enterprises (SOEs) are important actors in the global economy. Some countries have many SOEs. In others, SOEs are less prevalent but operate in sectors of strategic importance such as public utilities. Sound financial governance of SOEs means better fiscal management and more efficient resource allocation in the broader economy. *Policy makers come under growing pressure to ensure that SOEs create value for their owners who are, ultimately, the taxpayers and the broader public*."[185]

It could be argued that SOEs should be privatised and that state support should be given to private firms to allow them to perform public interest functions. Special rules such as the European SGEI regime could then be applied to these entities to ensure that they are able to receive support to fulfil their mandates. It is at least conceivable that private firms would be able to perform these mandates more efficiently than SOEs. However, it would seem that the very broad role that public interest plays in South Africa would make this impossible. Moreover, it is clear that this would not be possible in the current political climate. It is clear that the government will not give up control over aspects of the economy where they already have strong influence. It is for this reason that the state aid regime proposed in this thesis will also propose more limited powers for regulators in South Africa than the powers which the EU Commission has in Europe with regard to state aid.

It is unrealistic to expect the South African government to completely step back from financially assisting SOEs to help them achieve their mandates. If the government did not provide state aid to commercialised SOEs to help them achieve their governmental mandates, it would place them at a disadvantage in comparison to their private competitors because SOEs have to achieve both their pure commercial goals and governmental mandates.[186] Since the majority of SOEs have a developmental role and a socio-economic purpose, it is understandable that the government would not want to have any limitations placed on its capabilities to provide state aid to SOEs. And no government agency or the courts should intrude upon this power because the South African government, like governments all over

[185] My emphasis.
OECD *Financing State-Owned Enterprises: An Overview of National Practices* (2014) 7.
[186] See in this regard the general comments made in OECD *Financing State-Owned Enterprises: An Overview of National Practices* (2014) 10.

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the world, should be able to act in the general public interest without restrictions. This principle was recently upheld when the High Court stated that:

> "The government had a wide discretion to select the means to achieve constitutionally permitted objectives and the courts could not interfere simply because they did not like them or because other means might have been selected."[187]

This statement may have been made in regard to SAA only, but it is without a doubt the position with respect to every government financial intervention concerning SOEs. It is important to be conscious of the limitations of South Africa's competition laws in the context of the state's financing of SOEs. It is outside the ambit of competition law to limit the state's ability to achieve its developmental goals. Any attempt to try and eliminate state aid to SOEs completely, for purposes of protecting competitors of SOEs, is unrealistic in South Africa. Because SOEs are seen as the "service delivery arm of Government that ensures accelerated socio-economic development",[188] competition law cannot blindly be extended to the state funding of SOEs. For as long as South Africa's socio-economic problems persist, it will remain necessary for the government to grant state aid to SOEs in order for those SOEs to fulfil their socio-economic purposes. The state's prerogative to intervene financially when required for the sake of all South Africans can therefore not be limited by the application of competition law and it is recognised that any such limitations would not be easily considered.

However, continuous financial irregularities, poor governance and repeated anticompetitive behaviour[189] within SOEs make it difficult to always justify the privileges enjoyed by them on the basis of their socio-economic mandates.[190] Ellyne crucially observes that "State-owned enterprises can serve South Africa's

[187] *Comair Ltd v Minister of Public Enterprises* 2016 (1) SA 1 (GP) 2.
[188] SOEs were described as such by the Department of Telecommunications and Postal Services. See (https://www.dtps.gov.za/index.php?option=com_content&view=article&id=229&Itemid=105).
[189] These enterprises commit anticompetitive practices to the same or perhaps even a greater degree than their private counterparts. Only because they have socio-economic mandates does not necessarily mean that they do not commit anticompetitive practices.
[190] See those privileges listed by Geddes in para 1.1 of this chapter.

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development state ambitions. But sound policies and governance practices are needed to ensure they stand as value creators and do not become financial burdens to the public purse." As a result it is submitted that the socio-economic mandates of SOEs should not entirely exclude the possibility of having regulatory measures in regard to state aid.

2 2 Supranational status of the EU and state aid in related countries

The most obvious difference between South Africa and the EU is that the EU is a supranational institution. It should be asked whether it is appropriate for South Africa to implement state aid control rules based on a regulatory framework which was created for multiple states, each with their own SOEs. The EU state aid control rules formed a central part of its integration because a system was needed to ensure that governments did not benefit their own enterprises with state aid, to the disadvantage of enterprises in other member states. Even though trade barriers in the EU were removed as a result of economic integration, the provision of state aid to enterprises by member states would have negated such removal. The supranational status of the EU is clearly one of the reasons why state aid regulation functions properly. For this reasons it will be more difficult to implement a similar system in a single state.[191]

This is illustrated by the problems that have been encountered in the "candidate countries"[192] in South-Eastern Europe with which the EU have concluded Stabilization and Association Agreements[193] and the "EU neighbourhood"[194]

[191] See para 2 of chapter 4 for a complete discussion of the reasons for the restrictions on state aid in the EU.
[192] At present the "candidate countries" are Albania (candidate status in 2014); the Republic of North Macedonia (candidate status in 2005), Montenegro (candidate status 2010) and Serbia (candidate status 2012).
[193] The EU has concluded Stabilization and Association Agreements with Kosovo (2014), Macedonia (FYR) (2001), Serbia (2008), Montenegro (2007); Albania (2006); and Bosnia-Herzegovina (2008). Kosovo and Bosnia-Herzegovina do not have the status of "candidate country" yet but are considered to be "potential candidate" countries.
[194] This refers to the following countries, although the EU has different forms of relations with them: Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Kyrgyz, Lebanon, Libya, Moldova, Morocco, Palestine, Syria, Tunisia and Ukraine (https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/international-economic-relations/enlargement-and-neighbouring-countries/neighbouring-countries-eu_en) last visited on 7 February 2020.

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countries with which the EU have concluded Association Agreements which provide for the establishment of a "deep and comprehensive" free trade area.[195]

The legislative basis for the Stabilization and Association Agreements and Association Agreements is Article 49 of the TEU, Article 8 of the TEU and Article 217 of the TFEU. Article 49 allows for any European State to become a member state of the EU as long as it respects the values[196] of the EU and is committed to promote such values. Article 8 of the TEU allows the EU to enter into association agreements with neighbouring countries not necessarily to become member states, but to develop a "special relationship" and to conclude agreements with these countries which may have reciprocal rights and obligations. Article 217 allows the EU to conclude association agreements with third countries which involved reciprocal rights and obligations, common action and special procedure.

With the prospect of membership, "candidate countries" are expected to comply with the "Copenhagen Criteria"[197] and align their laws and policies with that of the EU. "EU neighbourhood countries" who want to develop a "special relationship"[198] with the EU are also required to align their laws with EU laws. The requirement for alignment is inherently part of both the Stabilization and Association Agreements which were concluded with the "candidate countries" in South-Eastern Europe and the Association Agreements which were concluded with "EU neighbourhood" countries like Ukraine, Moldova and Georgia. The Stabilization and Association Agreements prepare "candidate countries" for membership of the EU and the Association Agreements together with the "Deep and Comprehensive Free Trade

[195] The Association Agreement with Ukraine, Moldova and Georgia are examples of agreements which include the establishment of a "Deep and Comprehensive Free Trade Area". For a discussion the Ukraine Association Agreement see E Stuart & I Roginska "State Aid Regulation and Future Industrial Policy in Ukraine" (2016) 1 *European State Aid Law Quarterly* 59-71 where the authors note some of the difficulties Ukraine has experienced while transposing EU law into national law.

[196] See these values in Article 2 of the TEU. See "European Council in Copenhagen 21-22 June 1993: Conclusions of the Presidency" (available at https://www.consilium.europa.eu/media/21225/72921.pdf).

[197] The "Copenhagen Criteria" were adopted by the EU at the European Council meeting in Copenhagen in 1993. In terms of these requirements candidate countries need to achieve stability of institutions to "guarantee democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the [EU]." See "European Council in Copenhagen 21-22 June 1993: Conclusions of the Presidency" (available at https://www.consilium.europa.eu/media/21225/72921.pdf).

[198] See for example the association agreements which the EU concluded with Ukraine, Georgia and Moldova.

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Area" Agreement prepare "EU neighbouring" countries for a "special relationship"[199] with the EU. With these agreements the EU aims to integrate EU law over a period of time into the national law of associated countries and to achieve harmonisation of national law with EU law.[200] Therefore these agreements include "principles, concepts and provisions of EU law which are to be interpreted and applied as if the third State is part of the EU."[201] Even if there are instances when the agreements may contain clauses which are directed at country-specific issues,[202] the broader aims of both the Stabilization and Association Agreements and Association Agreements, which make provision for a "deep and comprehensive" free trade area, are generally similar. The aims, inter alia, include:

(i) political, economic and institutional stability;

(ii) the development of a political relation between the EU;

(iii) the strengthening of democracy and the rule of law;

(iv) the transitioning into a functioning market economy;

(v) the promotion of harmonious economic relations and the gradual develop of a free trade area with the EU;

(vi) to provide an appropriate framework for enhanced political dialogue; and

(vii) the fostering of regional cooperation in all the fields covered by the agreement.

The association agreements thus establish a broad framework for the relationship between the EU and the countries with which the agreements are concluded and they ensure greater cooperation and continuous dialogue in a number of policy areas, such as economic and monetary policy, environmental policy and consumer protection. Competition policy, including state aid control, also forms part of the policy areas covered in the association agreements. As with other policy areas, the

199 In this regard special reference can be made to the Association Agreements concluded with Ukraine, Moldova and Georgia.

200 C Pippan "The Rocky Road to Europe: The EU's Stabilisation and Association Process for the Western Balkans and the Principle of Conditionality" (2004) 9(2) *European Foreign Affairs Review* 219 233.

201 R Dragneva & K Wolczuk "The EU-Ukraine Association Agreement and the challenges of inter-regionalism" (2014) 39(3/4) *Review of Central and East European Law* 213 222.

202 See C Pippan "The Rocky Road to Europe: The EU's Stabilisation and Association Process for the Western Balkans and the Principle of Conditionality" (2004) 9(2) *European Foreign Affairs Review* 219 225; and N Simidjiyska "From Milosevic's reign to the European Union: Serbia and Montenegro's Stabilization and Association Agreement" (2007) 21(1) *Temple International & Comparative Law Journal* 147-176. See also the study done by the EU on associated agreements: "A study on the law and practice of EU association agreements" https://www.europarl.europa.eu/RegData/etudes/STUD/2019/608861/IPOL_STU(2019)608861_EN.pdf.

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EU ensured through the associaition agreements that the position on state aid control in "candidate countries" in South-Eastern Europe and "EU neighbourhood" countries with which it has a "special relationship", replicates its state aid regime. Hence, the Stabilization and Association Agreements with "candidate countries" and Association Agreements[203] (like the ones that make provision for a "deep and comprehensive" free trade area) contain provisions on state aid control.[204] These provisions require that the "candidate countries" and "EU neighbourhood" countries implement a domestic system of state aid control[205] and establish an "operationally independent authority", which will be in place until accession,[206] to enforce the domestic system. According to Botta and Schwellnus[207] the requirement to establish national monitoring authorities[208] was first introduced in the European Agreements (EAs)[209] which were concluded between the EU and the Central and Eastern European countries (CEE-countries).[210] The authors further note that the EU included this requirement in the EAs after it realised the "tremendous challenge" of

[203] See for instance the Association Agreement between the EU and Ukraine, which is in effect since September 2017. It replaced the Partnership and Cooperation Agreement of 1998 between the EU and Ukraine is one example where the EU required an "EU neighbourhood" country to implement a domestic state aid control system which replicates the position in the EU (the EU-Ukraine Association Agreement is available at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A22014A0529%2801%29). For more on the position in Ukraine regarding state aid control see See E Stuart & I Roginska "State Aid Regulation and Future Industrial Policy in Ukraine" (2016) 1 *European State Aid Law Quarterly* (2016) 59 59; R Croce & H Stakheyeva "Competition law and state aid reform in light of EU-Ukraine Association Agreement and its impact on business in Ukraine" (2014) 35(1*) European Competition Law Review* 23-28; and A Dimitrova & R Dragneva "Shaping Convergence with the EU in Foreign Policy and State Aid in Post-Orange Ukraine: Weak External Incentives, Powerful Veto Players" (2013) 65(4) *Europe-Asia Studies* 658 672.

204 The Association Agreement with Georgia is an exception in this regard. Even though it provides for a "deep and comprehensive" free trade area between Georgia and the EU, it does not incorporate EU state aid rules. Instead, it includes the WTO rules on subsidies in Article 206.

[205] Article 75 of the Stabilization and Association Agreement between the EU and Kosovo; Article 69 of the Stabilization and Agreement between the EU and Macedonia (FYR); Article 73 of the Stabilization Agreement between the EU and Serbia; Article 73 of the Stabilization and Association Agreement between the EU and Montenegro; Article 71 of the Stabilization Agreement between the EU and Albania; Article 267 of the Association Agreement between the EU and Ukraine; and 341 of the Association Agreement between the EU and Moldova.

[206] After accession the competence shifts to the EU Commission.

[207] M Botta & G Schwellnus "Enforcing state aid rules in EU candidate countries: a qualitative comparative analysis of the direct and indirect effects of conditionality" (2015) 22(3) *Journal of European Public Policy* 335 337. See also DV Popovic & F Caka "State Aid Control in South-East Europe: Waiting for a Wake-up Call" (2017) 18 European Business Organization Law Review 333 334.

208 For a comprehensive list of the national authorities which enforced state aid rules in the CEE-countries before accession was completed see L Biegunski (2012)"Forms of State Aid Authorities in Associated Countries of Central and Eastern Europe" (2012) 3 European State Aid Law Quarterly 567 568.

[209] In this regard reference can be made to the Europe Agreements that were concluded between the EU and with Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

[210] These countries included Estonia, Slovenia, Estonia, Hungary, and the Czech Republic, all of which became member states during the 2004 enlargement.

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having to monitor all restructuring aid which the CEE-countries granted to former SOEs after they were privatized.[211] The Stabilization and Association Agreements with "candidate countries" and the Association Agreements with "EU neighbourhood countries" do not stipulate how the national monitoring authorities should be structured. This was also the position in the EAs.[212] Hence, the institutional design of the national monitoring authorities differed to a great degree in the CEE-countries.[213] The same position is now seen in "candidate countries" and "EU neighbourhood" countries where the enforcement of the national state aid legislation is either done by a government-linked body or an existing competition authority.[214] In nearly all the "candidate countries" in South-Eastern Europe the enforcement of national state aid legislation was entrusted to a government-linked body:[215]

-In Serbia it is the Commission for the Control of State Aid, under the auspices of the Ministry of Finance.[216]

-In Montenegro it is the Commission for the Control of State Aid, which seems to have very little independence from the government since the members of the Commission is appointed by the government and the Chairperson of the Commission is proposed by the Minister of Finance.[217]

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[211] M Botta & G Schwellnus "Enforcing state aid rules in EU candidate countries: a qualitative comparative analysis of the direct and indirect effects of conditionality" (2015) 22(3) *Journal of European Public Policy* 335 337.

[212] See M Cremona "State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements (2003) 9(3) *European Law Journal* 265 268 and A Birnstiel & H Heinrich "State Aid in the accession States" in E Szyszczak (ed.) *Research Handbook on European State Aid Law* (2011) 44 47.

[213] See in this regard L Biegunski "Forms of state aid authorities in associated countries of Central and Eastern Europe" (2012) 11(3) *European State Aid Law Quarterly* 567–72.

[214] See in this regard DV Popović "Institutional Design of State Aid Authorities in South East Europe: The Unfit Legal Transplant and Its Ramifications" in B Begović & D Popović (eds*) Competition Authorities in South Eastern Europe* (2018) para 3 where the author states the two diverse methods followed by "Candidate Countries" when they established their national monitoring authority.

[215] See in this regard DV Popović "Institutional Design of State Aid Authorities in South East Europe: The Unfit Legal Transplant and Its Ramifications" in B Begović & D Popović (eds*) Competition Authorities in South Eastern Europe* (2018) par. 3 and DV Popovic & F Caka "State Aid Control in South-East Europe: Waiting for a Wake-up Call" (2017) 18 *European Business Organization Law Review* 333 340-344.

[216] DV Popovic & F Caka "State Aid Control in South-East Europe: Waiting for a Wake-up Call" (2017) 18 *European Business Organization Law Review* 333 341.

[217] DV Popovic & F Caka "State Aid Control in South-East Europe: Waiting for a Wake-up Call" (2017) 18 *European Business Organization Law Review* 333 341.

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- In Albania it is the State Aid Commission and the State Aid Directorate, but the independence of the State Aid Commission, which is the main body for state aid control, is questionable since it is chaired by the Minister of the Economy.[218]
Macedonia is the only "candidate country" which entrusted the enforcement of national state aid law to its existing competition authority, the Commission for the Protection of Competition.[219] In Ukraine and Moldova, both "EU neighbourhood countries", the Antimonopoly Committee of Ukraine (AMC) and the Moldovan Competition Council (MCC) respectively are responsible for enforcing the national state aid legislation. Both the AMC and the MCR are described as "reasonably independent" from the government[220] or an "autonomous agency".[221]

These different national monitoring authorities are required to enforce the national system of state aid control until accession, when the EU Commission becomes the sole enforcer of the supranational state aid rules.[222] But the enforcement of a national system of state aid control by monitoring authorities can be a daunting task. Challenges faced by national monitoring authorities, *inter alia*, include:

1. Difficulty in applying complex EU law in a single jurisdiction that is not yet a member state. Schutterle[223] alerts to the challenges faced by associated countries when having to implement the EU state aid rules where he states:

> "For the law makers, administrations and enterprises of the Candidate Countries, the acceptance, transposal into domestic rules and effective implementation of the EC

[218] DV Popovic & F Caka "State Aid Control in South-East Europe: Waiting for a Wake-up Call" (2017) 18 *European Business Organization Law Review* 333 343.
[219] DV Popović "Institutional Design of State Aid Authorities in South East Europe: The Unfit Legal Transplant and Its Ramifications" in B Begović & D Popović (eds) *Competition Authorities in South Eastern Europe* (2018) par. 3 and DV Popovic & F Caka "State Aid Control in South-East Europe: Waiting for a Wake-up Call" (2017) 18 *European Business Organization Law Review* 333 344.
[220] E Stuart & I Roginska "State Aid Regulation and Future Industrial Policy in Ukraine" (2016) 1 *European State Aid Law Quarterly* 59-71.
[221] http://documents.worldbank.org/curated/en/298941468278112747/pdf/911820BRI0COLL0a0Competition0Policy.pdf (visited on 13 February 2020).
[222] M Botta "State Aid Control in South-East Europe: The Endless Transition" (2012) 1 *European State Aid Law Quarterly* 83 83.
[223] P Schutterle "Implementing of the EC State Aid Control: An Accession Criteria" (2002) 1(1) *European State Aid Quarterly* 79 79.

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> State aid acquis is one of the major legal, economic and probably also mental challenges of accession preparation."

According to Ciric and Botta,[224] misapplication or neglect of EU state aid rules frequently occurs in these countries and it has manifested particularly in regard to SGEI in the SEE-countries. The authors show that in nearly every SEE-country,[225] the *Altmark* criteria are either being neglected or misapplied when the national monitoring authorities have to decide whether aid granted to a provider of SGEI constitute state aid.[226] They advise that:

> "The lack of enforcement of the EU *acquis* during the accession phase may have long term negative consequences once the candidate country finally joins the EU. Therefore, the EU Commission should carry out a deeper scrutiny of the decisions adopted by the State aid authorities during the pre-accession, in order to ensure a *defacto* enforcement of the State aid rules."[227]

2. The very lengthy transitional periods during which the national monitoring authorities have to apply the national system of state aid control. This may impact on how effective the rules are being enforced. Botta[228] points out that the length of transition into an EU member state for "candidate countries" in South-Eastern Europe has significantly increased and this may undermine the incentive to rigorously enforce the state aid rules.

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[224] See R Ciric & M Botta" "Enforcement of State Aid Law in the Area of Services of General Economic Interest in EU Candidate Countries (2015) 2 *European State Aid Law Quarterly* 213-223.
[225] In this regard the authors mention a decision which was adopted by the Croatian national competition authority. See R Ciric & M Botta "Enforcement of State Aid Law in the Area of Services of General Economic Interest in EU Candidate Countries (2015) 2 *European State Aid Law Quarterly* 213 220.
[226] R Ciric & M Botta "Enforcement of State Aid Law in the Area of Services of General Economic Interest in EU Candidate Countries (2015) 2 *European State Aid Law Quarterly* 213-223.
[227] R Ciric & M Botta "Enforcement of State Aid Law in the Area of Services of General Economic Interest in EU Candidate Countries (2015) 2 *European State Aid Law Quarterly* 213 223.
[228] M Botta "State Aid Control in South-East Europe: The Endless Transition" (2012) 1 European State Aid Law Quarterly 83 84.

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3. Reluctance by granting authorities to notify aid and uncertainty as to the applicability of the rules on the side of the national monitoring authority.[229] Botta explains the reluctance to notify as "a lack of awareness by several state aid providers of their binding duty of notification" and advise for more advocacy.[230] It is submitted that this can lead to a situation where state aid which should not have been granted is indeed granted firstly, because it was not notified and secondly because the national monitoring authority might not pursue the public authority which granted the aid because of uncertainty on its side.

4. A lack of independence of national monitoring authorities in associated countries. Botta[231] states that at least four[232] of the current "candidate countries" have opted for the establishment of a State Aid Commission, which is normally headed by the Minister of Finance and that it is very unlikely for the Minister of Finance to condemn as unlawful state aid which in most cases would have been granted by the department of which he is the head.

5. Uncertainty as to whether local authorities make correct decisions on a state aid scheme without supervision of the EU Commission. Ciric and Botta[233] note that the EU Commission does not check whether decisions by national monitoring authorities are correct and in line with decisions from the CJEU while Cremona[234] states that there is no basis under which the EU Commission will review specific decisions of the national monitoring authority in the associate countries and the national monitoring authority is also not obliged to consult the Commission. The absence of review by the EU Commission in essence leads to a situation where state aid, which the Commission might have considered incompatible with the internal market, are

[229] See in this regard M Botta & G Schwellnus "Enforcing state aid rules in EU candidate countries: a qualitative comparative analysis of the direct and indirect effects of conditionality" (2015) 22(3) *Journal of European Public Policy* 337 and M Botta "State aid control in south-east Europe, the endless transition" (2013) 12(1) *European State Aid Law Quarterly* 85–96.
[230] M Botta "State aid control in south-east Europe, the endless transition" (2013) 12(1) *European State Aid Law Quarterly* 83 91.
[231] M Botta "State aid control in south-east Europe, the endless transition" (2013) 12(1) *European State Aid Law Quarterly* 83 88.
[232] These include Albania, Serbia, Montenegro and Kosovo.
[233] R Ciric & M Botta "Enforcement of State Aid Law in the Area of Services of General Economic Interest in EU Candidate Countries (2015) 2 *European State Aid Law Quarterly* 213 214.
[234] M Cremona "State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements (2003) 9(3) *European Law Journal* 265 282.

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approved by the national monitoring authority as they are considered to be in line with the national state aid legislation.

With all the challenges to the enforcement of a national system of state aid control in mind, Cremona[235] is rightly sceptical of the appropriateness of importing "into a single State a system designed to deal with inter-State competitiveness". Cremona also notes the "practical difficulties of applying Community norms and standards outside the procedural structures, integration mechanisms and single market objectives of actual EU membership."[236] Botta[237] is perhaps correct when he concludes that:

> "The EU founding fathers were well aware that the EU Member States would have not been willing to self-enforce a system of State aid control, and thus they delegated this function to a supranational body like the European Commission. This logic is still valid today, both for the EU Member States, and as well as for the SEEs, which hopefully sooner rather than later will complete their transition to join the EU family."

Botta further concludes that:[238]

> "national State aid authorities should not be granted the decision- making power to review and approve national State aid schemes. The power of approving/rejecting the notified aid schemes should be granted only to a supranational authority, which is more likely to preserve its autonomy from the aid grantors. [The] the European Commission should thus have the power to review notified national aid schemes of the EU candidate countries since they gain the EU candidate status. This task, in fact, cannot be delegated to a national authority…"

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[235] M Cremona "State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements (2003) 9(3) *European Law Journal* 265 267.
[236] M Cremona "State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements (2003) 9(3) *European Law Journal* 265 266.
[237] M Botta "State aid control in south-east Europe, the endless transition" (2013) 12(1) *European State Aid Law Quarterly* 83 94.
[238] M Botta "State Aid Control in South-East Europe: The Endless Transition" (2013) *European State Aid Law Quarterly* 83- 94.

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Since the EU state aid rules are used as the yardstick for the proposed national state aid legislation, these doubts about the appropriateness of supranational rules for a single state have to be kept in mind. Some of the difficulties mentioned will not be directly relevant to the question whether a single state such as South Africa should have state aid rules:

- Some of these problems will not be unique to single states that attempt to enforce state aid rules, but they will be prevalent in any new jurisdiction that applies state aid rules.
- Other problems may be unique to the European system. The problems regarding the application of the complex web of European norms of state aid fall into this category. For South Africa this merely shows that the European state aid rules must be carefully approached when they are imported.
- Furthermore, certain difficulties exist because state aid rules in this context are applied to align countries with the EU often for purposes of future accession. This does not mean that it would not be worthwhile to apply a state aid regime in a single country that is not interested in future membership of the EU.

However, it is also clear that a major concern is that monitoring authorities which are merely state institutions will not be able to properly supervise state aid and enforce state aid law. South Africa is likely to also face this obstacle. At least in Europe related countries may apply state aid rules as they are incentivised by closer co-operation or membership of the EU. In South Africa there is no such incentive. It should therefore be asked whether state aid rules for South Africa cannot be accommodated in a regional framework.

2 2 1 Selected Regional Economic Communities in Africa and their competition policies[239]

[239] This study does not intend to provide a comprehensive discussion of those selected regional economic communities. Many scholars and experts on African integration have done admirable work in this regard. What the study will indeed do is to take a closer look at the competition policies of those selected regional economic communities. For more information on the competition regimes within the various African regional economic communities see T Hartzenberg "Competition Policy in Africa" in C Herrmann, M Krajewski & JP Terhechte (eds) *European Yearbook of International Economic Law* (2013) 147 165. See also AB Darku & AB Appau "Analysing Sub-Saharan Africa Trade Patterns in the Presence of Regional Trade Agreements- The case of COMESA, SADC, ECCAS and ECOWAS (2015) 17(1) *The African Finance Journal* 41 41- 66.

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As it would be preferable to enforce state aid rules in a supra-national structure, it therefore should be asked whether there is a structure in Africa within which state aid of SOEs can be properly regulated and whether South Africa could become part of such a structure. Such questions justify a closer look at selected African regional economic communities and their competition policies,[240] including SADC, to show why the study suggests state aid rules for South Africa as a single state only and not for the regional economic community of which it is a member state. In this context it can be stated that multinational integration is not completely new to the African continent. There are multiple regional economic communities on the continent.[241] Since there is no economic integration in Africa on a continental level which is comparable to the EU, besides the African Union, which is mostly a political organisation, regional economic communities are the most likely vehicles for economic development. Regional economic communities are in most cases inter-governmental organisations, rather than supranational bodies, that aim to improve the economies of their regions. Hart observes that (i) suspicion, (ii) political instability and (iii) an unwillingness to give up elements of state sovereignty are some of the reasons why complete integration is difficult on the African continent.[242] The benefits of regional economic integration[243] were noted by many African countries after obtaining their independence with the end of colonialism. Van Weijen states that due to the small size of African markets, economic integration was needed to create

[240] See J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber *Competition Policies and Regional Integration in Developing Countries* (2012) for a worthwhile and comprehensive read on the interface between regional integration and competition policy.

[241] For a comprehensive reading on the various economic groupings see N Mwase "Coordination and Rationalisation of Sub-Regional Economic Integration Institutions in Eastern and Southern Africa: SACU, SADC, EAC and COMESA" (2008) 9(4) *Journal of World Investment and Trade* 333 333-352.

[242] SG-A Hart "Integrating Trade and Human Rights in West Africa: An Analysis of the Ecowas Experience" (2000) 32 *Windsor Review of Legal and Social Issues* 57 59.

[243] Long before the establishment of Africa's first regional economic communities, regional integration to ensure the maintenance of international peace and security was already recognised by the United Nations when it signed its United Nations Charter in 1945. Article 52 (1) of the UN Charter provides that:
"Nothing in the present Charter precludes the existence of regional arrangements or agencies for dealing with such matters relating to the maintenance of international peace and security as are appropriate for regional action provided that such arrangements or agencies and their activities are consistent with the Purposes and Principles of the United Nations." Since the inception of the UN Charter, different parts of the world have seen the creation of regional arrangements which do not only work towards peace and security but also towards economic, political and social development. Examples are the European Union in Europe, Mercosur in South America, described as a process of integration which started in 1991 between Brazil, Argentina and Paraguay and Uruguay [see F Domínguez & MA Guedes de Oliveira *Mercosur: Between Integration and Democracy* (2004)] and the North American Free Trade Agreement (NAFTA) in North America signed in December 1992 between the United States of America, Canada and Mexico, described as the "most comprehensive free trade pact" [see GC Hufbauer &JJ Schott *NAFTA: An Assessment* (1993)].

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economies of scale.[244] Goldstein and Ndung'u state some of the reasons for African states joining regional groupings and these include (i) improving economic policy, (ii) reducing poverty, and (iii) managing the process of liberalisation.[245] The regional economic communities on the continent are the Economic Community of West African States (ECOWAS), Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), Economic Community of Central African States (ECCAS), and Southern African Development Community (SADC).[246]

The introduction of legislation enacted by a supranational body could be a perfect opportunity for African states, which do not have the necessary capabilities, to establish regulation in a field such as competition law and policy. African states appear to be reluctant to surrender their sovereignty with regard to regulation of competition in general to a supranational body.[247] It is even less likely that they will give up their sovereignty with regard to state aid.[248] It will certainly be more difficult to establish state aid rules, than it was for the six[249] original members of the EU when they decided to establish the first European Communities.[250] All the above factors make it difficult to make recommendations for SADC or any other regional economic community of which South Africa is a member.

A discussion of selected regional economic communities will now follow. This discussion will show that some regional organisations such as COMESA do have competition rules in place which may apply cross-border under certain

[244] J Van Weijen "COMESA, free trade area by October 2000" (2000) 6(5) *International Trade Law & Regulation* 153 153. See also BD Nomvete "Regional Development and Economic Cooperation in Africa" (1993) 61(4) *South African Journal of Economics* 281 281- 289.
[245] See A Goldstein & NS Ndung'u "Regional Integration Experience in the Eastern African Region" *OECD Development Centre Working Paper No 171* 8.
[246] For comprehensive reading on Africa's regional economic organisations see RF Oppong "The African Union, The African Economic Community and Africa's Regional Economic Communities: Untangling a Complex Web" (2010) 18 *African Journal of International and Comparative Law* 92 92-103.
[247] This is the case even though those African states that are COMESA member states have already partially submitted to COMESA's regional competition legislation. See the discussion on COMESA's competition legislation in para 2.2.1 of this chapter.
[248] See the discussion on state aid rules in the selected regional economic communities below in this chapter. Para 2.2.1.1 (c) discusses the position in COMESA, para 2.2.1.2 (c) discussion the position in SADC and para 2.2.1.3 (ii) discussed the position in ECOWAS.
[249] Germany, France, Italy, Belgium, Luxembourg and the Netherlands.
[250] See para 3 of chapter 4 for a discussion of the founding European Communities.

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circumstances, but at present[251] there is no supra-national enforcer comparable to the European Commission and it appears unlikely that state aid rules will be adopted by the regional organisations of which South Africa is or could be a member state. This discussion will also help to establish whether state aid rules introduced in South Africa is likely to be followed and implemented in one or more of Africa's regional economic communities with the necessary changes to suit them. The three selected regional economic communities[252] whose competition policies will be scrutinized are COMESA, SADC and ECOWAS, which together with the EAC have been described as "Africa's four leading RECs today".[253] Firstly, COMESA is discussed because it is considered to be one of the "largest trading organizations"[254] in Africa and has "Africa's first supranational competition authority".[255] It covers Africa's eastern and southern regions and member states stretch from Libya in the north to Swaziland in the south. Secondly, SADC is discussed because South Africa is a member state. Thirdly, ECOWAS is discussed since Nigeria, Africa's second biggest economy, is a member state and it played a leading role in the formation of ECOWAS: the country was the driving force behind West African integration in the 1960s.[256]

2 2 1 1 COMESA

(a) Background to COMESA

> "The Common Market for Eastern and Southern Africa is a programme essentially aimed at opening up the internal market made up of about 320 million people. It is a programme to create a common economic and social area which will give people new opportunities for development. It is a programme intended to promote more

[251] This might change when the ECOWAS draft legislation is implemented. See the discussion on ECOWAS's competition regime in para 2.2.1.3 of this chapter.
[252] There are of course other regional economic organisations such as the East African Community, the Economic Community of Central African States, the Arab Maghreb Union but these will not be part of this study's scrutiny.
[253] This description was given by K Gottschalk "The African Union and its sub---regional Structures" (2012) 1(1) *Journal of African Union Studies* 9 23.
[254] COMESA was described as such in JW Salacuse *The Three Laws of International Investment: National, Contractual and International Frameworks for Foreign Capital* 1 ed (2013) 349.
[255] P Steyn "Africa's First Supranational Competition Authority Commences Operations: Issues Arising from the New COMESA Merger Control Regime" (2013) 9 (2) *Competition Law International* 137-147.
[256] See OJB Ojo "Nigeria and the Formation of ECOWAS" (1980) 34(4) *International Organization* 571 571-572.

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> competition but also more co-operation. It is a programme aimed at removing obstacles to trade and investment but establish minimum set of rules that must be followed up, for without this the market cannot function in a balanced manner."[257]

COMESA was created in 1993 by the Treaty for the Common Market for Eastern and Southern African Community[258] after its humble beginnings as a preferential trade area agreement between eastern and southern African states. The Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States (the PTA treaty) was signed between eastern and southern African countries[259] after various efforts to achieve economic cooperation.[260] The PTA treaty came into force in September 1982.[261] In terms of Article 2 of the PTA treaty it was the first step towards the establishment of a common market amongst eastern and southern African states. The aim of the preferential trade area was to promote co-operation and development amongst member states in all fields of economic activity.[262] In 1993 COMESA became the successor of the Preferential Trade Area for Eastern and Southern African States (the PTA) when the PTA Treaty was reconstituted as COMESA. Today COMESA consists of nineteen member states[263] although it does not include South Africa.

(b) Why is South Africa not a COMESA member state?

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[257] See H Sinare "The Treaty Establishing the Common Market for Eastern and Southern Africa: What is New, What Future Prospects" (1995) *Basic Documents of International Economic Law* para 8.

[258] For a short and concise summary on COMESA and its objectives see JJ Henning "Convergence of governance systems in SADEC: the OHADA and COMESA examples" (2003) 28(3) *Journal for Juridical Science* 156 156-164. See also KK Mwenda "Legal Aspects of Regional Integration: COMESA and SADC on the Regulation of Foreign Investment in Southern and Eastern Africa" (1997) 9(2) *African Journal of International and Comparative Law* 325 325-331.

[259] The African states which sign the Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States (the PTA Treaty) on 21 December 1981 includes Comoros, Djibouti, Ethiopia, Kenya, Malawi, Mauritius, Somalia, Uganda and Zambia.

[260] In this regard see J Van Weijen "COMESA, free trade area by October 2000" (2000) 6(5) *International Trade Law & Regulation* 153 153.

[261] J Van Weijen "COMESA, free trade area by October 2000" (2000) 6(5) *International Trade Law & Regulation* 153 153. See also D Van der Merwe "Economic cooperation in Southern Africa: Structures, Policies, Problems" (1991) 24(3) *The Comparative and International Law Journal of Southern Africa* 386 392.

[262] Article 3 of the PTA Treaty.

[263] The member states are Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Seychelles, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. Those countries which were part of the initial efforts in 1966 to achieve the economic community includes Burundi, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Somalia, Tanzania, and Zambia. In this regard see J Van Weijen, "COMESA, free trade area by October 2000" (2000) 6(5) *International Trade Law & Regulation* 153 153.

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South Africa has been given the opportunity, upon fulfilling certain obligations,[264] to become a member state of COMESA.[265] However until now, it has chosen not to become a member state. This prompts the question why South Africa as one of the leading southern African states has made this choice. Ngongola states that due to the different regional integration arrangements in southern Africa there was going to be speculation with regard to the arrangement which South Africa would prefer.[266] It is not unreasonable to suggest that there must have been hopes within all southern African regional arrangements that South Africa would become a member, not only because it is the leading economy on the continent but also because of other factors such as its influence in the world and the degree to which its laws are developed and naturally for trade reasons. SADC however was South Africa's preferred choice.[267]

The South African government never provided particular reasons for choosing SADC over COMESA. It has also not opted for membership of both regional economic communities as many other African states have done.[268] Although such an overlapping of membership between SADC and COMESA might not be problematic[269] for those countries which have chosen to do so, South Africa might view it as problematic for several reasons. Firstly, a membership fee has to be paid to both organisations. Perhaps South Africa believes that it will not get value from paying two membership fees. Secondly, South Africa might have wanted to avoid having to comply with two sets of rules (that could include rules on competition).[270] Double membership could cause significant duplication of South Africa's

[264] See Article 1 of the COMESA Treaty.
[265] See Article 1 of the COMESA Treaty.
[266] C Ngongola "The reconstitution of the Southern African Development Community: Some International Trade Law perspectives" (2000) 117(2) *South African Law Journal* 256 256.
[267] South Africa became a member state on 9 August 1994. See S Amos "The role of South Africa in SADC regional integration: the making or braking of the organization" (2010) 5(3) *Journal of International Commercial Law and Technology* 124 124.
[268] Countries with membership to both RECs include the Democratic Republic of Congo, Madagascar, Malawi, Mauritius, Seychelles, Swaziland, Zambia and Zimbabwe.
[269] Such overlapping membership of regional economic communities does not necessarily have to be negative. See for example SK Afesorgbor & PAG Van Bergeijk "Measuring Multi- Membership in Economic Integration and its Trade Impact: A Comparative Study of ECOWAS and SADC" (2014) 82(4) *South African Journal of Economics* 518 518-530 where the authors looked at multi-membership and its impact within the Economic ECOWAS and SADC. The authors found that "overlapping memberships had a much stronger and significant positive effect on bilateral trade within ECOWAS compare with an insignificant impact within the SADC."
[270] There currently are no regional rules and regulations in regard to competition policy within SADC but only a cooperation framework. See the discussion in para 2.2.1.2 (b) of this chapter.

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responsibilities in terms of the competition law regime of COMESA and the possible regime of SADC on the one hand and South Africa's domestic competition law regime on the other hand. Lastly, another factor which could be looked at is the diversity of legal systems in the countries which belong to COMESA. Member countries range from common and civil to Islamic law.[271] This however is not such a significant factor where SADC is concerned. At least eleven of the SADC member states were under former British control, either as a protectorate or a colony and it is inevitable that British legal principles are being applied today in many SADC countries with South Africa having a hybrid legal system. It is therefore submitted that known common legal principles make it easier for a group of countries to negotiate rules and regulations for their institution.[272]

(c) Competition Policy within COMESA: The COMESA Competition Regulations and the COMESA Competition Rules

The legal foundation of COMESA's competition policy can be found in Article 55 and Article 52 of the COMESA Treaty respectively. Article 55[273] deals with prohibited agreements and concerted practices between undertakings which may impact negatively on competition within the Common Market. Article 52 declares any subsidies by member states which may distort or threaten to distort competition by favouring certain undertakings or the production of certain goods, to be incompatible

[271] D Kayihura "Parallel jurisdiction of courts and tribunals: the COMESA Court of Justice perspective" (2010) 36(3) *Commonwealth Law Bulletin* 583 583-592.

[272] For a comprehensive discussion of the convergence of legal systems in Southern Africa see G van Niekerk "The convergence of legal systems in Southern Africa" (2002) 35(3) *The Comparative and International Law Journal of Southern Africa* 308 308-318.

[273] Article 55 of the COMESA treaty provides as follows:
"1. The Member States agree that any practice which negates the objective of free and liberalised trade shall be prohibited. To this end, the Member States agree to prohibit any agreement between undertakings or concerted practice which has as its objective or effect the prevention, restriction or distortion of competition within the Common Market.
2. The Council may declare the provisions of paragraph 1 of this Article inapplicable in the case of:
(a) any agreement or category thereof between undertakings;
(b) any decision by association of undertakings;
(c) any concerted practice or category thereof;
which improves production or distribution of goods or promotes technical or economic progress and has the effect of enabling consumers a fair share of the benefits:
Provided that the agreement, decision or practice does not impose on the undertaking restrictions inconsistent with the attainment of the objectives of this Treaty or has the effect of eliminating competition.
3. The Council shall make regulations to regulate competition within the Member States."

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with the Common Market. Consequently these two articles should be looked at together.

Article 55(3)[274] empowers the Council of COMESA to enact regulations to regulate competition within member states. Such regulations were enacted in 2004[275] and became the COMESA Competition Regulations.[276] COMESA recognised that the expansion of business activities beyond borders of the member states may also increase the likelihood that anti-competitive practices in one member state may adversely affect competition in another member state.[277] The purpose of the Regulation is thus to promote and encourage competition within COMESA by (i) preventing restrictive business practices and other restrictions that deter the efficient operation of markets and (ii) to protect consumers against offensive conduct by market actors.[278] As such it enhances the welfare of the consumers in the region.[279] The Regulations apply to all economic activities, conducted by private or public persons, which have an effect within COMESA.[280] Hence, all transactions with a regional dimension and impact fall within the scope of the COMESA Competition Regulations while all other transactions are still addressed by the national competition authorities of the COMESA member states.[281] Unlike EU rules, which contain no definition of the concept "undertaking"[282] and had to be interpreted by the EU courts, the COMESA Competition Regulations contain a clear definition of the concept. It includes any person, public or private, involved in the production of goods

[274] Article 55(3) provides as follows: "The Council shall make regulations to regulate competition within the Member States."
[275] The Regulations can be found in the *Official Gazette of the Common Market for Eastern and Southern Africa* (2012) 17(12).
[276] The COMESA Competition Commission which was established in terms of Article 6 of the COMESA Competition Regulations and the Board of Commissioners (the Board) which was established in terms of Article 12 of the COMESA Competition Regulations are responsible for enforcing the COMESA Competition Regulations.
[277] See the Preamble of the COMESA Competition Regulations.
[278] Article 2 of the COMESA Competition Regulations.
[279] Article 2 of the COMESA Competition Regulations.
[280] Article 3 of the COMESA Competition Regulations.
There are some exclusions listed in this article and these includes collective bargaining between employers and employees for fixing terms and conditions of employment, activities by trade unions and other associations which intends to advance to advance the terms and conditions of their member's employment, activities of professional associations which intend to set professional standards for member of the associations necessary for the protections of public interest.
[281] See M Reynolds "Interview with David Lewis, Executive Director, Competition Watch" (2014) 10(2) *Competition Law International* 141 141.
[282] See para 1.1 of chapter 2 and para 2.1.1 of chapter 1 for the discussion on the concept of an undertaking as it is found in the EU.

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or trade in goods or the provision of services.[283] The COMESA competition law provisions will therefore clearly apply to SOEs and their activities.

COMESA, unlike the EU, has however not made state aid regulation part of its Competition Regulations. As previously mentioned, article 52[284] of the COMESA treaty deals with subsidies granted by member states which may have a distortive effect on competition. Nevertheless, the COMESA competition authorities[285] do not have the power to investigate subsidies granted by member states, even if such subsidies may impact on competition in the region. Instead, the COMESA treaty[286] allows for countervailing duties to be levied by a member state which imports a subsidised product from another member state. The countervailing duty will be an amount equal to the estimated subsidy determined to have been granted directly or indirectly by a member state for the manufacturing, production or export of any product. This position is thus reflective of those provisions in the WTO's Agreement on Subsidies and Countervailing Measures which provides for countervailing duties on subsidised products.[287] The following observations can therefore be made in regard to the COMESA subsidy control provisions:

[283] Article 1 of the COMESA Competition Regulations.
[284] It provides as follows:
"1. Except as otherwise provided in this Treaty, any subsidy granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the Common Market.
2. A Member State may, for the purposes of offsetting the effects of subsidies and subject to regulations made by the Council, levy countervailing duty on any product of any Member State imported into another Member State equal to the amount of the estimated subsidy determined to have been granted directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation."
3. Except as otherwise provided in this Treaty, any subsidy granted by a third country or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States and the third country, be incompatible with the Common Market.
4. A Member State may, for the purposes of offsetting the effects of subsidies and subject to regulations made by the Council, levy a countervailing duty on any product of any third country imported into another Member State equal to the amount of the estimated subsidy determined to have been granted directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation."
[285] See the discussion below in this paragraph on the powers of the COMESA Competition Commission.
[286] Article 52 (2) of the COMESA treaty.
[287] See the discussion of the WTO subsidy rules in para 9 of chapter 4.

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First, although the wording of Article 52 of the COMESA treaty bears only slight resemblance to the EU's state aid control provisions,[288] in essence it reaches the same results as the EU state aid rules because the COMESA subsidy control regime does not only ensure fair trade between the member states but it also ensure that certain undertakings or production lines are not benefitted to the disadvantage of others. Furthermore, the protection of competition in COMESA is not compromised because of the possibility of countervailing duties by member states whose undertakings are disadvantaged by subsidies. Member states are therefore not left without recourse if subsidies affect competition.

Second, like the EU treaty, the COMESA treaty does not provide a definition of the term subsidy. The EU jurisprudence provides guidance on the scope of the term "subsidy". It remains to be seen what the COMESA Court of Justice[289] will include under this concept: that is whether it will be a broad or narrow interpretation and even perhaps whether COMESA will follow the same route as the EU in this regard.

Third, Article 52 of the COMESA treaty makes no distinction between private and state-owned undertakings. Hence, it would not be unreasonable to infer that the subsidy control regime is also applicable to SOEs.

Lastly, beside the prohibition on the allocation of subsidies and state resources to an undertaking or for the production of certain goods by a member state, Article 52 also extends its scope to assistance by a third country[290] which may impact on competition within COMESA.

(d) Comments on the COMESA competition policy

The COMESA Competition Regulations, as in the EU, has supranational application in regard to anticompetitive acts with a cross-border dimension. Such status has

[288] For a detailed comparison between the EU state aid control regime and the WTO subsidy regime see L Rubini *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (2009).
[289] The Court of Justice was established in terms of Article 7 of the COMESA Treaty as one of the organs of the Common Market. The Court of Justice became operational in 1998. See Articles 19- 44 of the COMESA treaty for, inter alia, the composition, functions and jurisdiction of the Court of Justice.
[290] Which means any country other than a member state of COMESA.

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been established by Article 10 of the COMESA Treaty which determines that regulations made by the Council, shall be binding on all member states. In this regard the COMESA competition authorities are correctly described as "Africa's first supranational competition authority".[291] This is especially true because COMESA has a Competition Commission which has the legal capacity to perform and execute all those functions bestowed on it by the Competition Regulations in the territory of each member state.[292] The Competition Commission[293] is responsible for promoting competition within COMESA by, inter alia, monitoring and investigating any anti-competitive practices by undertakings within COMESA, reviewing regional competition policy with the view to constantly improving the Competition Regulations, and assisting member states to promote national competition laws with the objective of harmonising the national laws with the COMESA Competition Regulations.[294] It has significant powers to remedy and penalise anticompetitive conduct by undertakings within COMESA.[295]

Furthermore, COMESA's subsidy control regime aims to protect free and fair competition by prohibiting subsidies that may distort competition. This brings COMESA's subsidy control rules somewhat closer to the EU state aid control regime. However, this regime cannot be fully compared with the EU's state aid control regime.

2 2 1 2 SADC

(a) Background to SADC

Thomas refers to two important regional and international developments that motivated African countries to desire closer ties, namely (i) the independence of

[291] P Steyn "Africa's First Supranational Authority Commences Operations: Issues Arising from the New COMESA Merger Control Regime" (2013) 9(2) *Competition Law International* 137 137-148.
[292] Article 6 of the COMESA Competition Regulations.
[293] See Article 9- 15 for the composition of the bodies responsible for administering the Commission's affairs
[294] Article 7 of the COMESA Competition Regulations.
[295] Article 8 of the COMESA Regulations.

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African countries from their colonial powers and (ii) the end of the cold war.[296] Moreover, there are related but somewhat unique reasons why SADC was established.

SADC has its roots in the Southern African Development Coordination Conference (SADCC).[297] The SADCC was established after the adoption of a declaration, the "Southern Africa: Towards Economic Liberation" Declaration (the Declaration), in April 1980 in Lusaka, Zambia.[298] The goals of the SADCC were listed as (i) the reduction of economic dependence on the Republic of South Africa in particular, (ii) closer links to create greater regional integration, (iii) implementation of national, interstate and regional policies through the use of available resources and (iv) to secure international cooperation and support for the economic liberation of the region.[299] It has been widely stated that the SADCC was southern African countries' response to the dominance of apartheid South Africa in the southern region of Africa.[300] The heads of state of the nine countries which signed the Declaration, aimed for economic development and independence from South Africa[301] and an integrated development of the region.[302] Thomas argues that the need for closer economic relations in other parts of the world, such as in Latin America, was another

[296] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland-Tanzania-Zambia-Zimbabwe: Treaty of the Southern Africa Development Community" (1993) 32 *International Legal Materials* 117 117.

[297] See C Ngongola "The Reconstitution of the Southern Africa Development Community: Some International Trade Law Perspectives" (2000) 117(2) *South African Law Journal* 266 266- 273 for a comprehensive historical background of SADC.

[298] Countries which were part to the Declaration include Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe. See M Forere "Is discussion of the "United States of Africa" premature? Analysis of ECOWAS and SADC integration efforts" (2012) 56(1) *Journal of African Law* 29 38.

[299] See these goals quoted in JB Boyd Jr "A Subsystemic Analysis of the Southern African Development Coordination Conference" (1985) 28(4) *African Studies Review* 46 47; and R Leys & A Tostensen "Regional Co-operation in Southern Africa: The Southern African Development Co-Ordination Conference" (1982) 9(23) *Review of African Political Economy* 52 53.

[300] See for example VI Goncharov, CRD Halisi & Y Tarabrin "Recommendations: Southern African Development Coordination Conference and African Security" (1988) 17(1*) Issue: A Journal of Opinion* 37 37. See also M Forere "Is discussion of the "United States of Africa" premature? Analysis of ECOWAS and SADC integration efforts" (2012) 56(1) *Journal of African Law* 29 38; and GG Maasdorp "A Changing Regional Role for SADCC?" (1989) 12(1) *Harvard International Review* 10 10.

[301] At that time the Apartheid regime in South Africa was at it heights.

[302] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland-Tanzania-Zambia-Zimbabwe: Treaty of the Southern Africa Development Community" (1993) 32 *International Legal Materials* 117 117. See also M Forere "Is discussion of the "United States of Africa" premature? Analysis of ECOWAS and SADC integration efforts" (2012) 56(1) *Journal of African Law* 29 38.

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reason why southern African countries wanted closer ties.[303] Forere supports this observation by Thomas when he states that:

> "It was not only dependence on South Africa that prompted SADCC states to resort to integration of the southern Africa region, but also the emergence of powerful trading arrangements in other regions of the world that prompted African leaders into finalizing their own plans for a pan-African Economic Community (AEC), to evolve from RECs with specific trade liberalization and market integration targets."[304]

From the early 1990s there were several reasons why the states which signed the Declaration which established the SADCC wanted South Africa as a member of a newly constituted organization. Positive developments in South Africa towards a democratic dispensation at the time begged consideration on the position of the SADCC towards South Africa.[305] It was foreseen that a democratic South Africa would be a good possible partner in any integration efforts in the southern region.[306] According to Thomas, it was also considered that the political change in South Africa was going to lead to greater investment in the whole southern region but with South Africa as the "preferred choice".[307] Thomas noted the following factors that would make South Africa the "preferred choice" for investment as: (i) South Africa had a more attractive investment climate at the time, (ii) its infrastructure, which is comparable with that of developed countries and (ii) its managerial, technical and technological capacities were better than those of other countries in the region.[308] Consequently, a summit was held in Windhoek, Namibia, in August 1992 during

[303] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland-Tanzania-Zambia-Zimbabwe: Treaty of the Southern Africa Development Community" (1993) 32 *International Legal Materials* 117 117.
[304] See also M Forere "Is discussion of the "United States of Africa" premature? Analysis of ECOWAS and SADC integration efforts" (2012) 56(1) *Journal of African Law* 29 38.
[305] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland" (1993) 32 *International Legal Materials*117 117.
[306] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland" (1993) 32 *International Legal Materials*117 117.
[307] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland-Tanzania-Zambia-Zimbabwe: Treaty of the Southern Africa Development Community" (1993) 32 *International Legal Materials* 117 117.
[308] See the Introductory note to the SADC Treaty by RH Thomas "Angola-Botswana-Lesotho-Malawi-Mozambique-Namibia- Swaziland-Tanzania-Zambia-Zimbabwe: Treaty of the Southern Africa Development Community" (1993)32 *International Legal Materials* 117 117.

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which the Treaty of the Southern African Development Community was adopted. SADC was established and its objectives, inter alia, include development and economic growth of the region as well as to alleviate poverty and enhance the standard and quality of life of people of southern Africa.[309] In August 1994, a few months after its first democratically elected government was inaugurated, South Africa became a member of SADC. At present SADC consists of fifteen member states.[310]

(b) Competition Policy within SADC: the Declaration on Regional Cooperation in Competition and Consumer Policies

The SADC treaty does not have specific competition-related provisions. Nevertheless, Article 21 of the SADC treaty allows for member states to cooperate in all areas necessary to foster regional development and integration while Article 22 of the treaty states that member states may conclude protocols to govern such areas of cooperation. The SADC Trade Protocol is one such protocol. It entered into force in January 2001 as a result of the member states' recognition that the development of trade is essential to the economic integration of SADC[311] and also because of member states' desire to achieve greater cooperation in the area of trade.[312] Article 2 states the objectives of the Trade Protocol as (i) to liberalise intra-regional trade in goods and services on the basis of fair, mutually equitable and beneficial trade arrangements, (ii) to ensure efficient production within SADC, (iii) to contribute towards the improvement of the climate for investment, (iv) to enhance the economic development, diversification and industrialisation of the SADC region, and (v) to establish a free trade area within the SADC region.

With regard to competition policy Article 25 of the Trade Protocol provides that member states shall implement measures within the community which prohibit unfair business practices and promote competition. SADC recognised the crucial role

[309] See Article 5 of the Treaty on the Southern African Development Community.
[310] The SADC member states are Angola, Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.
[311] See the Preamble of the SADC Trade Protocol.
[312] See the SADC Trade Protocol of 1996.

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which competition policies could play in achieving among other goals, economic growth and economic efficiency within the region.[313] It was however noted that not all member states of the SADC have competition policies in place. Therefore a community-wide approach for the protection of competition became necessary to guard against unfair business practices. There are also other reasons for a SADC-wide competition policy besides the rooting out of unfair business practices. Firstly, the level of development of the different economies of the SADC member states has to be kept in mind. On the one hand a member state such as South Africa has a fairly well-run economy but some other economies are not doing as well, either because of political instability in a country, such as in Zimbabwe, or because of a lack of foreign direct investment. Secondly, some member countries have sophisticated competition policies in place with effective enforcement institutions, while the same cannot be said of other member states. Consequently SADC agreed on a system of effective cooperation in the application of member states' competition laws.

In September 2009 the SADC member states signed the Declaration on Regional Cooperation in Competition Law and Consumer Policy (the DRCCC). The DRCCC derived from Article 25 of the Protocol on Trade in the SADC region. Article 1 of the DRCCC requires member states to adopt, strengthen and implement the necessary competition laws with the ultimate aim of achieving a regional framework in competition policy. The DRCCC in its present form is therefore only a cooperation framework[314] and focuses on "effective cooperation" between member states which have their own functional national competition law regimes. The cooperative nature of the DRCCC was confirmed when member states signed a Memorandum of Understanding on Inter-Agency Cooperation in Competition Policy, Law and

[313] See the Preamble of the SADC Declaration on Regional Cooperation in Competition and Consumer Policies.
[314] The DRCCC the system of cooperation between national competition authorities is overseen by the Competition and Consumer Policy Law Committee (the Law Committee) which is situated within the SADC Secretariat. The Law Committee, inter alia, assists member states to develop and implement competition policies and laws, helps with dialogue between national competition authorities in order to foster good cooperation in regard to competition matters and helps member states with ways to deal with the effects of any anticompetitive practices. See Article 2 of the SADC Declaration on Regional Cooperation in Competition and Consumer Policies.

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Enforcement (SADC MoU) on 26 May 2016 in Gaborone, Botswana.[315] The main objective of the Memorandum of Understanding is to enhance the enforcement of national competition laws through closer cooperation between national competition authorities.[316] The effect of such cooperation[317] in essence will lead to the sharing of information on cases and coordinated approaches to the investigation of cases.[318]

(c) State intervention and subsidies in SADC

The position in SADC with regard to the granting of subsidies by member states is based on the WTO subsidy rules. Article 19 of the SADC Trade Protocol of 1996, which deals with subsidies by member states, seeks to protect trade between member states and prevent distortion of competition through the regulation of subsidies. Article 19(1) of the SADC Trade Protocol provides that member states shall not grant any subsidies which distort or threatens to distort competition in the region and that member states may implement a new subsidy only in accordance with the WTO rules.[319] Member states are allowed to protect trade and by extension competition through the levying of countervailing duties against another member state if a subsidy was granted by that other member state.[320] The prohibition of subsidies in the SADC Trade Protocol is therefore the only reference to state funding of enterprises by member states.

(d) Comments on the SADC competition policy

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[315] The Memorandum of Understanding on Inter-Agency Cooperation in Competition Policy, Law and Enforcement (https://www.tralac.org/images/Resources/SADC/SADC%20MOU%20on%20Cooperation%20in%20the%20field%20of%20Competition%20Policy,%20Law%20and%20Enforcement%20signed%2026%20May%202016.pdf).

[316] Preamble of the "Memorandum of Understanding amongst Competition Authorities of the Member States of Southern African Development Community on Cooperation in the field of Competition Policy, Law and Enforcement".

[317] A Joint Committee will facilitate the cooperation between national competition authorities and the national competition authorities of each member state will have a representative serving on the Committee. While serving in such a position no representative of a member state shall be required to communicate information which is considered to be confidential information in terms of domestic law. See Articles 3 and 5 of the "Memorandum of Understanding amongst Competition Authorities of the Member States of Southern African Development Community on Cooperation in the field of Competition Policy, Law and Enforcement".

[318] https://www.sadc.int/news-events/news/competition-authorities-sadc-member-states-signed-memorandum/ (accessed on 12 March 2017).

[319] See para 9 of chapter 4 for a discussion on the WTO rules.

[320] Article 19 of the SADC Protocol on Trade.

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Unlike COMESA,[321] SADC competition rules do not have a supranational existence and there is no supranational body to enforce competition law. In regard to antitrust matters, SADC's framework for protecting competition generally is not as strong as that of COMESA. The reason for this is that cooperation only might not be as successful or effective as enforcement by a supranational enforcer, especially if the competition authorities from one member state are not as capable or cooperative as others. The supranational status[322] of COMESA competition law with regard to matters with a cross-border dimension provides it with wider powers to investigate such activities. It allows the COMESA Competition Commission to be the main investigator while in SADC it might be that more than one national competition authority has to start its own investigation into the same antitrust matter. Even with coordinated approaches as provided for by the SADC MoU, one anticompetitive activity may lead to multiple investigations running concurrently because more than one national competition authority will be investigating it. As a result the investigation of one antitrust matter may have an impact on the resources of more than one national competition authority. Another observation is that, unlike the COMESA Competition Regulations, the SADC Trade Protocol is not unambiguously applied to all undertakings, private or public.

In regard to the subsidy control regime, it is submitted that SADC has recognised the need to control state intervention with trade and by extension competition when it decided to implement the WTO subsidy rules. Article 19(1) of the SADC Trade Protocol, like the provisions in the COMESA treaty, closely matches the WTO rules on subsidies by member states and has little in common with the EU state aid rules. SADC's position however, is somewhat weaker than COMESA's when it comes to making member states aware of the potential distortive impact of subsidies. It is submitted that the existence of the COMESA regional competition authority and competition system could make the difference. Although COMESA competition authorities do not have state aid related powers they may discourage member states from granting subsidies and make them aware of the negative impact of subsidies on

[321] COMESA's supranational status only applies in regard to particular antitrust matters.
[322] See the discussion on the supranational status of the COMESA competition authorities in para 2. 2.1.1 (d) of this chapter.

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trade, competition and the economy as a whole. SADC does not have a regional competition authority which could do the same. In SADC there are only individual competition authorities of the member states. They may find it politically difficult to address state aid of their own governments or the governments of other member states.

SADC's current cooperation-only framework in regard to competition matters, together with its application of the WTO subsidy rules, means it is not sensible to propose a state aid control system for SADC. Hence, South Africa as a single state and not as a member of SADC is the focus of the proposals made in this study.

2 2 1 3 ECOWAS

(a) Background on ECOWAS

ECOWAS is an economic community which comprises all the countries of West Africa, both "anglophone and francophone".[323] It has its headquarters in the Federal Republic of Nigeria. Forere states that the idea for a regional body for West African countries to accelerate economic growth was already raised in 1964 even though ECOWAS was only formally created in 1975.[324] Poor economic conditions in the region and the quest for more significant cooperation and trade relations amongst countries in the region played a crucial role during the formation of the idea to establish an economic community.[325]

The treaty for the economic community of West African states was signed at Lagos in May 1975.[326] It established ECOWAS which at present consists of sixteen

[323] A Adedeji "Prospects of Regional Economic Co-Operation in West Africa" (1970) 8(2) *The Journal of Modern African Studies* 213 224. For more on the formation of ECOWAS see also B Fagbayibo "Common Problems Affecting Supranational Attempts in Africa: An Analytical Overview" (2013) 16(1) *Potchefstroom Electronic Law Journal* 31 35-36; and SO Oloruntoba "ECOWAS and Regional Integration in West Africa: From State to Emerging Private Authority" (2016) 14(7) *History Compass* 295 295–303.
[324] M Forere "Is discussion of the "United States of Africa" premature? Analysis of ECOWAS and SADC integration efforts" (2012) 56(1) *Journal of African Law* 29 38.
[325] TV Greer "The Economic Community of West African States: Status, Problems and Prospects for Change" (1992) 9(3) *International Marketing Review* 25 26.
[326] This original treaty was revised in 1993.The revised treaty was completed at Cotonou on 24th July 1993. The ECOWAS treaty of 1975 was terminated when the Executive Secretariat received instruments of ratification of

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member states.[327] The aims and objectives of ECOWAS inter alia include (i) to promote co-operation and integration within the region, (ii) to establish an economic union in West Africa which will raise the living standards of its people, (ii) to maintain and enhance economic stability of the region, (iv) to foster relations among the ECOWAS member states, and (v) to contribute to the progress and development of the African Continent.[328] To achieve these aims and objectives various requirements have to be met by the ECOWAS member states such as (i) the harmonisation and co-ordination of national policies on a variety of matters such as transport, communications, energy and education, (ii) the harmonisation and co-ordination of policies for the protection of the environment (iii) the promotion of the establishment of joint production enterprises, (iv) the establishment of a common market and (v) the establishment of an economic union.[329]

Furthermore, ECOWAS is based on important fundamental principles which all member states have to adhere to. Such principles inter alia include (i) equality and inter-dependence of member states; (ii) solidarity and collective self-reliance; (ii) inter-State co-operation, harmonisation of policies and integration of programmes; (iv) non-aggression between member states; and (v) maintenance of regional peace.[330] Like all regional organizations, the aims and objectives of ECOWAS can only be achieved through the cooperation of member states and through the efficient performance of the ECOWAS institutions.[331] The member states of ECOWAS

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the revised Treaty from all member states. All Community Conventions, Protocols, Decisions and Resolutions made since 1975 though, remain valid and in force, except for those instances when these instruments are incompatible with the revised treaty. See Article 92 of the revised ECOWAS treaty. The EOWAS Treaty of 1975 is published in *International Legal Materials* (1975) 14(5) 1200 1200-1209. The ECOWAS Treaty of 1975 was signed by Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo, all of which were former colonies of Britain, France or Portugal except for Liberia.

[327] The current member states of the ECOWAS are Benin, Burkina Faso, Cape Verde, Cote d' Ivoire, the Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Sierra Leone, Senegal and Togo.

[328] Article 3 of the Revised Treaty of the Economic Community of West African States. In the ECOWAS treaty the aim of the treaty is stated as follows: "to promote co-operation and development in all fields of economic activity particularly in the fields of industry, transport, telecommunications, energy, agriculture, natural resources, commerce, monetary and financial questions an-: in social and cultural matters for the purpose of raising the standard of living of its peoples, of increasing and maintaining economic stability, of fostering closer relations among its members and of contributing to the progress and development of the African continent." See Article 1 of the ECOWAS treaty in *International Legal Materials* (1975) 14(5) 1200 1200-1209.

[329] Article 3 of the ECOWAS treaty.

[330] Article 4 of the EOWAS treaty.

[331] ECOWAS institutions include the Authority of Heads of State and Government, the Council of Ministers, the Community Parliament, the Economic and Social Council, the Community Court of Justice, the Executive

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cooperate on various matters such as agriculture,[332] industry, science, technology and energy,[333] the environment and natural resources,[334] transport, communications and tourism,[335] trade, customs, taxation, statistics, money and payments[336] and many more other areas. Competition within ECOWAS is one such area of cooperation.

(b) Competition Policy in ECOWAS: The Draft Legislation[337]

ECOWAS's competition policy emanates from Article 3 of the ECOWAS treaty which provides for the harmonization and coordination of national policies in the area of trade. Harmonised and cooperative trade would enhance economic stability if efficiency and competitiveness are achieved within the ECOWAS common market.[338] Comparable to the position within COMESA, the ECOWAS Competition authority deals with regional competition matters while domestic matters fall within the ambit of the competition authorities of individual member states.[339] The legal basis for the ECOWAS competition policy is found in two drafts Acts. The *Supplementary Act adopting Community Competition Rules and the Modalities of their Application within ECOWAS*[340] sets out the substantive competition rules which would be applicable within ECOWAS. The *Supplementary Act on the Establishment, Function of the Regional Competition Authority for ECOWAS*[341] deals with matters such as the creation, composition, duties and powers of the ECOWAS Competition

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Secretariat, the Fund for Co-operation, Compensation and Development, Specialised Technical Commissions and other institutions established by the Authority of Heads of State.
See Article 6 of the ECOWAS treaty.

[332] Article 25 of the ECOWAS treaty.

[333] Articles 26 to 28 of the ECOWAS treaty.

[334] Article 29 to 31 of the ECOWAS treaty.

[335] Articles 32 to 34 of the ECOWAS treaty.

[336] Articles 35 to 53 of the ECOWAS treaty.

[337] For more on the two pieces of draft legislation see T Hartzenberg "Competition Policy in Africa" in C Herrmann, M Krajewski & P Terhechte (eds) *European Yearbook of International Economic Law* (2013) 167 167.

[338] See the Preamble to Supplementary Act A/SA.1/06/08 adopting Community Competition Rules and the Modalities of their application within ECOWAS.

[339] EM Fox & D Crane *Global Issues in Antitrust and Competition Law* (2010) 522.

[340] Supplementary Act A/SA.1/06/08 adopting Community Competition Rules and the Modalities of their application within ECOWAS was done in Abuja in May 2008
(accessible at http://www3.nd.edu/~ggoertz/rei/rei260/rei260.35tt1.pdf). Also discussed in OECD *Investment Policy Reviews: Nigeria 2015* (2015) 219.

[341] Supplementary Act A/SA.2/06/08 on the Establishment, Function of the Regional Competition Authority for ECOWAS was done in December 2008 (available at http://www3.nd.edu/~ggoertz/rei/rei260/rei260.36tt1.pdf).

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Authority. ECOWAS wanted competition rules that are consistent with international standards and promote fairness in trade and effective liberalization of trade.[342] Both Acts remain only drafts since they have not yet officially come into force. Nevertheless, an overview of their provisions is warranted as the Acts will come into force when a number of constraints are addressed.[343]

(i) The Draft Supplementary Act adopting Community Competition Rules and the Modalities of their application within ECOWAS[344]

The Preamble to the Draft Act states that the relevant member states of ECOWAS have recognised that in order to achieve economic growth within the common market, the ECOWAS economy had to be efficient and competitive. The intention with the draft legislation was to implement competition rules[345] within ECOWAS which would "promote fairness in trade and effective liberalization of trade".[346] The ECOWAS competition rules[347] apply to all anticompetitive practices and mergers which may have an effect on trade within ECOWAS with certain activities exempted from the scope of its application.[348] Article 4 (3) also extends the application of the ECOWAS competition rules to SOEs.[349] Hence public enterprises in ECOWAS are

[342] Preamble to the Supplementary Act A/SA.1/06/08 Adopting Community Competition Rules and the Modalities of their Application within ECOWAS.
[343] See para (c) below for a discussion of these constraints.
[344] See P Kuruk "Negotiating Competition Policy in Multilateral Trade Agreements: European Union Overtures to West Africa and the WTO" (2005) 36 *University of Pennsylvania Journal of International Law* 651 685 for a discussion of the Draft ECOWAS legislation on competition.
[345] Article 13 of the ECOWAS Competition Rules provides that the application and the implementation of the Competition Rules will be enforced by the Regional Competition Authority. The "organizational and operating rules" of the Regional Competition Authority is defined in a Draft Supplementary Act on the Establishment, Function of the Regional Competition Authority for ECOWAS.
[346] Preamble of the Supplementary Act A/SA 1/06/08 adopting Community Competition Rules and the Modalities of their application within ECOWAS.
[347] Article 3 of the Supplementary Act A/SA 1/06/08 adopting Community Competition Rules and the Modalities of their application within ECOWAS states the purposes of the ECOWAS competition rules as follows:
"(a) promote, maintain and encourage competition and enhance economic efficiency in production, trade and commerce at the regional level;
(b) prohibit any anti-competitive business conduct that prevents, restricts or distorts competition at the regional level;
(c) ensure the consumers' welfare and the protection of their interests;
(d) expand opportunities for domestic enterprises in Member States to participate in world markets."
[348] Article 4 of the Supplementary Act A/SA 1/06/08 Adopting Community Competition Rules and the Modalities of their Application within ECOWAS.
[349] Article 4 (3) of the Supplementary Act A/SA 1/06/08 Adopting Community Competition Rules and the Modalities of their Application within ECOWAS.

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subjected to the same competition rules as other enterprises unless the application of the competition rules obstructs the performance or the particular tasks assigned to such enterprises.[350] ECOWAS member states will not be allowed to enact or maintain any measures which are contrary to the competition and state aid rules of ECOWAS but:

> "Enterprises entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Supplementary Act, in so far as the application of rules contained herein does not obstruct the performance, in law or in fact, of the particular tasks assigned to them."[351]

(ii) State aid to enterprises within ECOWAS

Article 8 of the ECOWAS Competition Rules deals with state aid to enterprises and mirrors Article 107[352] of the TFEU. Article 8 provides that:

> "(1) Except as otherwise provided in this Supplementary Act, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain enterprises or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the ECOWAS Common Market.
>
> (2) The following shall be compatible with the Common Market:
>
> (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; and
>
> (b) aid to remedy the damage caused by natural disasters or exceptional occurrences.
>
> (3) The following may be considered to be compatible with the ECOWAS Common Market:

[350] Article 9 of the ECOWAS Competition Rules.
[351] See Article 9 of the ECOWAS Competition Rules which mirrors the EU treaty. Article 106 of the EU treaty deals with public undertakings and undertakings to which member states grant special or exclusive rights. See the discussion in para 7 of chapter 4 which discusses state aid to public undertakings.
[352] See para 4 of chapter 4 for a detailed discussion of this provision.

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> (a) aid to promote the socioeconomic development of areas of the Community where the standard of living is exceptionally low or in which there is serious underemployment;
> (b) aid to promote the execution of an important project of Community interest or to remedy a serious disturbance in the economy of a Member State;
> (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
> (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest; and
> (e) such other categories of aid as may be specified by a decision of the Authority of Heads of State and Government on the recommendation of the Council of Ministers acting on a proposal from the ECOWAS Competition Authority."

It is no surprise that ECOWAS took the wording of its state aid control rules from the EU since the EU is the only supranational institution with effective state aid control rules. In the event that the draft legislation does become law, this extraordinary step by ECOWAS will be admirable especially if it is kept in mind that ECOWAS is made up of countries with relatively underdeveloped economies.[353] It is surprising that these countries seem to be prepared to accept significant constraints on their sovereignty with regard to state aid to their public undertakings and to leave it to ECOWAS to decide whether it is in order for them to grant state aid or not, should the draft legislation become law.

(c) Comments on the ECOWAS competition policy

ECOWAS has to be commended for the progress it has made in adopting a draft competition policy with supranational application, which would not be applicable to antitrust matters only but to state aid matters as well. This is especially significant

[353] See http://www.worldbank.org/en/countries/ for a complete economic overview and outlook of each ECOWAS member state.

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since many ECOWAS member states do not have competition policies of their own in place. Although it has been quite a while since the draft ECOWAS competition legislation was signed, there are still clear indications that ECOWAS strives to have its competition regime in effect in the near future.[354] In accordance with an agreement which was signed during the Heads of State Summit in Dakar, Senegal in June 2016, the ECOWAS Competition Authority's headquarters was assigned to the Republic of Gambia.[355] Furthermore, on 12 July 2018 President Adama Burrow of the Gambia, together with the United Nations (UN) Special Representative for West Africa and the Sahel, attended the inauguration of the ECOWAS Regional Competition Authority Headquarters in Bijilo, Gambia.[356]

The implementation of the ECOWAS competition regime will however not be easy as there are a number of constraints which will have to be address before it can come into effect. The most significant constraint is what Adebajo called "the different and at times competing integration projects between francophone and anglophone West Africa".[357] The West African Economic and Monetary Union, commonly known by its French acronym of UEMOA, is another regional organisation in West Africa. It was established on 10 January 1994 to replace its predecessor, the *Communaute Economuque de l' Afrique de Ouest* (CEAO).[358] Its member states consist of mostly the French-speaking[359] West African nations and all these countries[360] have the CFA franc as their common currency. All member states of UEMOA are also member

[354] These include inter alia the following:
(i)the amendment made to the Supplementary Act which established the ECOWAS Regional Competition Authority by Supplementary Act A/SA.4/07/13. It amends the Supplementary Act A/SA.2/12/08 on the Establishment, Functions and Operation of the Regional Competition Authority for ECOWAS (retrievable at http://www.ecowas.int/wp-content/uploads/2015/01/4-Regional-Competition.pdf); and
(ii) the signing of the headquarters agreement for the Regional Competition Authority during the ECOWAS Heads of State Summit which was held on the 4th of June 2016 in Dakar, Senegal. (See http://www.ecowas.int/signing-of-agreement-between-republic-of-the-gambia-and-ecowas-dakar-senegal-4th-june-2016/) (accessed on 10 August 2016).

[355] See http://www.ecowas.int/signing-of-agreement-between-republic-of-the-gambia-and-ecowas-dakar-senegal-4th-june-2016/ (last visited on June 2016).

[356] See "President of Economic Community of West African States (ECOWAS) Commission and the United Nations (UN) Special Representative for West Africa and the Sahel Concluded a High-Level Visit to the Gambia" 12 July 2018 SyndiGate Media Inc. Abuja.

[357] A Adebajo "Introduction" in A Adebajo & I Rashid (ed) *West Africa's Security Challenges: Building Peace in a Troubled Region* (2004) 1 4.

[358] See A Adebajo "Introduction" in A Adebajo & I Rashid (eds) *West Africa's Security Challenges: Building Peace in a Troubled Region* (2004) 1 4.

[359] Guinea- Bissau is the only Portuguese speaking West African country which is member state along with the French-speaking nations.

[360] These include Benin, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.

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states of ECOWAS.[361] The UEMOA has an existing competition law regime in place which governs both traditional competition affairs and the financial relations between member states and public enterprises.[362] Heineman states that a particular feature of the UEMOA competition law regime is the "radical centralization of competition law".[363] The author further states that "[the] WAEMU Commission has exclusive competence to apply competition law to the detriment of national competition authorities, which are restricted to cooperation with the regional authority."[364] The "strong degree of centralization" is sure to create conflict in regard to enforcement and coordination between the potential ECOWAS regional competition law regime and the existing competition law regime of UEMOA.[365] How to deal with such potential conflict scenarios need to be addressed before any further developments in regard to the ECOWAS competition law regime can take place. Therefore Adebajo's[366] doubt about the co-existence of ECOWAS and UEMOA is highly relevant even though the author makes his observations about the two organisations generally and not the two competition law regimes in particular. Adebajo firstly wonders, which of the two organisations' treaties will take precedence, since all UEMOA member states are also ECOWAS member states. The author secondly asks whether there eventually will be convergence between ECOWAS and UEMOA and if not whether the co-existence of the two organisations will "retard" market integration in West Africa. Thirdly, Adebajo wonders whether UEMOA will grant "most-favored-nation treatment" to other ECOWAS member states if its integration goals prove to be more successful than those of ECOWAS. Lastly, it is asked whether a common external tariff will also apply to other non-UEMOA ECOWAS member states.

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[361] See in this regard M Bakhoum "Introduction" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 1 6.
[362] M Bakhoum "Introduction" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 1 6.
[363] A Heinemann "Competition Policy and Regional Integration in Developing Countries edited by Josef Drexl, Mor Bakhoum, Eleanor M. Fox, Michal S. Gal and David J. Gerber" (2014) 45(3) *International Review of Intellectual Property and Competition Law* 375 376.
[364] A Heinemann "Competition Policy and Regional Integration in Developing Countries edited by Josef Drexl, Mor Bakhoum, Eleanor M. Fox, Michal S. Gal and David J. Gerber" (2014) 45(3) *International Review of Intellectual Property and Competition Law* 375 376.
[365] M Bakhoum "Introduction" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 1 6.
[366] A Adedeji "ECOWAS: A Retrospective Journey" in A Adebajo & I Rashid (ed) *West Africa's Security Challenges: Building Peace in a Troubled Region* (2004) 21 56.

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Multiple and overlapping membership of regional organisations is not only found in West Africa. It will be clear from previous sections that many African countries belong to more than one regional economic organisation. However, in this region it might create greater challenges, in light of the differences between ECOWAS countries, as noted by Ngom.[367]

(i) The differences in regard to the member states' legal systems because some have adopted the "common law" system and others the "civil law" system, depending on the member states' colonial past. Connected with this is the "linguistic diversity" of member states: the language of the member states' former colonial power, which includes English, Portuguese and French, is now often the governmental language of the member state. This could make it difficult to agree on the applicable legal system and the working language for the ECOWAS Regional Competition Authority;

(iii) The level of economic development of the member states, with least developed member states more prone to economic intervention by the state and more developed member states, such as Nigeria, leaning more towards private enterprise.

Ngom is however confident that these constraints will eventually be overcome, especially since economic development of all member states is the main objective of the ECOWAS competition policy[368] and the other regional organisations.

Whenever in the future these difficulties are overcome and the ECOWAS regional competition law regime comes into effect, there would be no formal difference between the legal position in ECOWAS and in the EU, with regard to state aid control. Although ECOWAS plans to have supranational status for its state aid rules in the future, it is realistic to acknowledge that it will take a while for that to happen and it might take generations for ECOWAS to achieve the same success as the EU. This however should not dampen the enthusiasm for Africa's first potential state aid control regime which expressly forms part of the competition rules and is not just aimed at confirming the subsidy rules of the WTO like COMESA and SADC did.

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[367] M Ngom "Regional Integration and Competition Policy in the Economic Community of West African States" In J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 116 121-122 Edward Elgar Publishing.

[368] M Ngom "Regional Integration and Competition Policy in the Economic Community of West African States" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 116 122.

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Similar success than that experienced by the EU is a possibility especially in light of the institutional and other changes which took place in 2006. One such change was that the ECOWAS Secretariat became the ECOWAS Commission.[369] Another significant change concerned the way ECOWAS laws are implemented within member states.[370] According to ECOWAS "Under the new legal regime, the principle of [supra-nationality] becomes more pre-eminent and there is now a de-emphasis on the adoption of Conventions and Protocols."[371] The position before the change was that new legislation, especially those setting out obligations for member states, were subjected to "lengthy Parliamentary ratification processes" which caused huge delays, while others such as "Decisions" had immediate applicability within member states.[372] The change to the legislative regime ensures that Supplementary Acts, which are "Community Acts"[373] and complementary to the ECOWAS revised treaty binds all member states and ECOWAS institutions immediately after it comes into force.[374] This places the implementation of ECOWAS laws in member states on the same footing as in the EU.

Both ECOWAS's draft Acts on competition policy were written as Supplementary Acts. Consequently, when these two Supplementary Acts come into force, they will be applicable within the member states without any need for ratification by the member states.[375] At present though the relevant provision in the ECOWAS Supplementary Act focuses only on the substance of a state aid prohibition. It does not provide any procedural rules which member states will have to follow when state aid is to be granted or existing aid to be altered.[376] This however should not create an obstacle to the implementation of the ECOWAS state aid control rules, especially in the light of the new ECOWAS legislative regime for Community Acts.[377] This new legislative regime will make it easier for the ECOWAS Competition Authority to

[369] See http://www.ecowas.int/ecowas-law/regulations-directives-and-other-acts/ (accessed on 10 August 2016).
[370] See http://www.ecowas.int/ecowas-law/regulations-directives-and-other-acts/ (accessed on 10 August 2016).
[371] See http://www.ecowas.int/ecowas-law/regulations-directives-and-other-acts/ (accessed on 10 August 2016).
[372] See the ECOWAS Commission at http://www.comm.ecowas.int/about-ecowas/ (accessed on 25 May 2016).
[373] Other "Community Acts" are Regulations, Directives, Decisions and Recommendations.
[374] See the ECOWAS Commission at http://www.comm.ecowas.int/about-ecowas/ (accessed on 25 May 2016).
[375] See J Ukaigwe *ECOWAS Law* 1 ed (2016) 201 for more on ECOWAS law and National Law.
[376] See Article 108 (3) of the TFEU and para 4 of chapter four for a comprehensive discussion of the procedural rules which EU member states have to follow when introducing state aid or altering existing aid.
[377] Community Acts include Supplementary Acts, Regulations, Directives, Decisions, Recommendations and Opinion. (see http://www.ecowas.int/ecowas-law/regulations-directives-and-other-acts/).

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propose a particular procedure to be adopted for notifying the granting of new aid or the altering of existing aid. Such a procedure can be implemented either by using a Regulation or a Supplementary Act which will have automatic effect in the member states.

The ECOWAS competition regime would be of great interest to other African regional economic communities. If successful it could point the way forward for other African regional economic communities although it still has a long way to go.

2 2 2 Concluding remarks on supranational status as an obstacle to a regional state aid control regime which could be applied to South Africa

State aid control rules, because of their nature, are only applicable to conduct by the State. However, it may not be easy to get the government to comply with its own rules: the government that enforces the rules will be the very same body that will have to comply with them and there is no assurance that there will be substantial compliance. This difficulty is eliminated in the EU by the supranational status of competition rules and the European Commission which ensures that member states do not violate the state aid control rules. The EU Commission can hold the government of a member state responsible if the rules are not complied with.[378]

Although a regional state aid control regime which could be applied to state aid in South Africa would have been ideal, at present it is just not realistic to suggest that such a system can be created. South Africa is a member state of the African Union (AU)[379] and a number of regional organisations, such as SADC[380] and the Southern African Customs Union (SACU).[381] None of them has sufficiently developed

[378] See para 8 of chapter 4 for a comprehensive discussion on the enforcement of the EU state aid prohibition.
[379] The AU's is mostly a political organisation and its objectives are stated in Article 3 of the Constitutive Act of the AU. Some of these objectives are to:
"(a) achieve greater unity and solidarity between the African countries and the peoples of Africa;
(b) defend the sovereignty, territorial integrity and independence of its Member States;
(c) accelerate the political and socio-economic integration of the continent;"
[380] See the discussion on SADC in para 2.2.1.2 of this chapter.
[381] See E Ngalawa & P Harold "Anatomy of the Southern African Customs Union: Structure and Revenue Volatility" (2014) 13(1) *The International Business & Economic Research Journal* 145 145-156 for more on SACU.

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competition law policies which could be applied in the same way as in the EU.[382] SADC is the regional economic community with the least developed competition policies.

There are also other reasons why the study focuses on South Africa as a single state only. Firstly, multiple and overlapping membership[383] of different regional organisations by African states may make it impossible to focus on one particular regional economic community and to recommend a state aid policy for any of them as it may cause problems of implementation if recommendations are to be considered. Secondly, the heterogeneous nature of the member states' economies also makes it difficult since some member states like South Africa have a bigger economy, while others, for example, Namibia or Malawi have much smaller economies. Thirdly, the extent to which competition laws and policies have been implemented in African states also plays a role. Even though many African countries have already marked their sixtieth year as independent states, many still do not have sufficient competition legislation in place in order for this study to suggest a regional state aid policy. The position in the SADC member states, for example, provides a clear picture of how the position in regard to competition laws and policies differs all over Africa. Mamhare divides the SADC member states into four categories in accordance with the level of development of competition policy in the states.[384] The first category is those SADC member states with "operational" competition laws and policies. The second category is those states which have passed laws without having implemented them yet. The third category includes those member states which are in the process of preparing competition laws and policies and lastly those

[382] See the discussion below in this chapter for the position on competition policy within SADC
Article 40 of the 2002 SACU Agreement is also short and concise on competition policy within SACU. It states that: "1. Member States agree that there shall be competition policies in each Member State. 2. Member States shall co-operate with each other with respect to the enforcement of competition laws and regulations."
The development of competition policy within COMESA and ECOWAS discussed below shows that some level of supranational application is possible if competition law is sufficiently developed.
[383] For a detailed discussion on overlapping membership of regional economic communities in Africa see S Buigut "Monetary Integration Initiatives in Eastern and Southern Africa (ESA): Sorting the Overlapping Membership" (2006) 9(3) *International Finance* 295 295–315.
[384] See G Mamhare "Southern African Development Community (SADC) regional competition policy" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 56 58.

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member states which are still preparing to implement competition laws.[385] What also plays a role is what Mamhare identifies as the "structural and substantive difference" between competition law models as well as the "degree of autonomy and independence" of the competition authorities.[386] Lastly, according to Bakhoum, although the benefits of regional competition policies are widely acknowledged, it is difficult to design competition laws and policies for developing countries which take into account their "economic, political and cultural situations".[387] Bakhoum further states that a regional competition policy should not be designed and implemented in the abstract but with consideration of the "local context", which keeps in mind the "historical context, the political situation, the economic feature of the member states, the size of the member states, the degree of intensity of trade within a common market, the legal traditions (civil law or common law), the language differences, and the institutional settings of the member states."[388]

In conclusion, the scrutiny of the position on competition law and state aid control in the three regional economic communities reaffirms the projection of this study that it will be difficult to implement any proposals for a regional state aid control regime in the regional economic community of which South African is a member state. Firstly, with ECOWAS trying hard to overcome the impediments which stand in the way of the implementation of a potential state aid control regime and the COMESA competition authorities being limited to the traditional antitrust matters due to the nature of the state subsidy rules, it is highly unlikely that SADC, after taking note of the positions in ECOWAS and COMESA, will consider any proposals on state aid control, especially not if it is part of competition policy. Its focus at present is on the cooperation between domestic competition authorities in antitrust matters only. Secondly, as much as COMESA's competition authority is Africa's first supranational

[385] G Mamhare "Southern African Development Community (SADC) regional competition policy" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 56 58.
[386] G Mamhare "Southern African Development Community (SADC) regional competition policy" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policy and Regional Integration in Developing Countries* (2012) 56 57.
[387] M Bakhoum "Introduction" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policies and Regional Integration in Developing Countries* (2012) 1 1.
[388] M Bakhoum "Introduction" in J Drexl, M Bakhoum, EM Fox, MS Gal & DJ Gerber (eds) *Competition Policies and Regional Integration in Developing Countries* (2012) 1 1.

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competition authority,[389] their hands are essentially tied when there is state aid as they are limited in their abilities to protect the competitive process against state financial aid by member states. Unless member states actively exercise their right to levy a countervailing duty against products which are subsidised by the member state from which it is imported, competition will inevitably be affected. Although they can make member states aware of the negative impact of subsidies on competition, they cannot force a member state to exercise its right to use countervailing duties and in essence protect competition. Inertia on the side of the member states could therefore mean that subsidised products will compete with similar or the same products which were not subsidised and even if this will undeniably distort competition within COMESA, there is not really much which the COMESA competition authority can do. Thirdly, with regard to ECOWAS one cannot help but to admire its desire to have similar state aid rules like the EU. However, it has to be recognised that the obstacles which stand in the way of the implementation of the state aid control regime, in particular questions as to the working language of its Competition Authority and the legal system which should be applied, will only be solved with willpower among all member states. In SADC similar will power will be required from the fifteen SADC member states to transition from a cooperation-only framework to supranational regulation of competition law similar to the position in COMESA. Even though the discussion on SADC has shown that there are existing challenges with SADC's cooperation-only framework,[390] it appears as if the SADC member states would rather focus on addressing these challenges instead of attempting to transition to a supranational competition law regime which would pose further and new challenges of a different nature. The challenges it would face to transition are wide-ranging. It inter alia includes:

(i) the absence of operational competition laws in some member states;

(ii) differences in economic conditions of the SADC member states;

(iii) different "political and cultural situations" in member states; and

(iv) overlapping membership of various regional economic communities

[389] P Steyn "Africa's First Supranational Competition Authority Commences Operations: Issues Arising from the New COMESA Merger Control Regime" (2013) 9 (2) *Competition Law International* 137-147.

[390] For further reading on the challenges facing SADC's cooperation framework see S Chapeyama *Developing a regional competition regulatory framework in the Southern African Development Community (SADC)* LLM (International Trade, Investment and Business law in Africa) University of the Western Cape (2015) para 3.6

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Chapeyama[391] correctly identifies other challenges to a potential SADC supranational competition law regime. These are (i) fear of loss of sovereignty; (ii) lack of political will; (iii) the lack of respect for the rule of law; and (iv) SADC's poor record with regard to the implementation of goals. There is no doubt that it will take a very long time and lots of convincing to bring the SADC member states close to a discussion on a potential transition to a supranational competition law regime.

Lastly, it is highly probable that SADC will continue to deal with state aid by member states to enterprises in the same way as it currently does should it get a supranational competition regime. This is because it is certain to follow COMESA in this regard as COMESA would by then continue to be the regional economic community with the most tested supranational competition law regime on the African continent. With COMESA's competition authority having no substantial powers to protect the competitive process against state financial aid except to create awareness among member states of its potential negative impact, it is doubtful that SADC would implement a system that goes any further. It will most certainly rely on the lessons learned by COMESA.

2 3 Further obstacles to the adoption of state aid rules for SOEs in South Africa

2 3 1 Government will be reluctant to give up its powers to decide on state aid to SOEs

The government is likely to resist having its powers to grant state aid to SOEs curbed. This is also observed in countries that apply state aid as they are related to the EU.[392] Such reluctance is not necessarily unacceptable if it is understood that all SOEs in South Africa have a public interest function and that they help the government to deliver some of its key responsibilities to South Africans.[393] However,

[391] S Chapeyama *Developing a regional competition regulatory framework in the Southern African Development Community (SADC)* LLM (International Trade, Investment and Business law in Africa) University of the Western Cape (2015) para 4.3
[392] See chapter 5 para 2.2.
[393] See the discussion in para 2.1 of this chapter on the public interest function of South African SOEs.

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it is proposed that there are good arguments why government should at least be prepared to subject its state aid to SOEs to limited scrutiny as proposed in the ensuing sections.

Firstly, these state aid rules could be designed to merely build on the government's recognition that free and fair competition amongst all firms is paramount for a strong economy. Through the enactment of the Competition Act, the government has recognised the significant positive changes which competition can bring for all South Africans. This recognition even forms part of the Preamble to the Competition Act where it states that "an efficient, competitive economic environment, balancing the interest of workers, owners and consumers and focussed on development, will benefit all South Africans."[394] Also, although market competition is not expressly protected in the Constitution, its importance for public welfare has been recognised by the courts. In *Phumelela Gaming and Leisure Ltd v Gründlingh*[395] the Constitutional Court had to consider whether principles of market competition were constitutionally recognised. It stated that the Bill of Rights does not expressly promote competition principles but that the right to freedom of trade which is enshrined in section 22 of the Constitution is "consistent with a competitive regime in matters of trade and the recognition of the protection of competition as being in the public welfare". In *Affordable Medicines Trust and Others v Minister of Health and Others*[396] the Constitutional Court justified the right to freedom of trade on the basis that: "In broad terms this section has to be understood as both repudiating past exclusionary practices and affirming the entitlements appropriate for our new open and democratic society. Thus, in the light of our history of job reservation, restrictions on employment imposed by the pass laws and the exclusion of women from many occupations, to mention just a few of the arbitrary laws and practices used to maintain privilege, it is understandable why this aspect of economic activity was singled out for constitutional protection." By extending the application of the Competition Act also to the economic activities of the state,[397] the government in essence gave effect to the desired "competitive economic environment." It is

[394] Preamble of the Competition Act. See also the discussions in para 1.1 of this chapter and para 4.3.8 of chapter 3.
[395] 2007 (6) SA 350 (CC) 363.
[396] 2006 (3) SA 247 (CC) para 58.
[397] See the discussion on Article 81 of the Competition Act in para 1.1 of this chapter.

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submitted that the government can do even more to achieve that desired "competitive economic environment" that will benefit all South Africans if it provides a system for the evaluation of certain state aid[398] which may have the potential to distort competition.

Secondly, the aims and visions of the National Development Plan 2030 can also be presented as motivation for the government to have certain state aid scrutinized. The National Development Plan aims to "eliminate poverty and reduce inequality by 2030". When persistent state aid is granted to SOEs due to avoidable actions, money is taken away from other developmental projects which could achieve the aims of the National Development Plan. Hence it would be beneficial to all South Africans if the government allows certain types of distortive state aid which could threaten the "competitive economic environment" to be evaluated.

Thirdly, the state aid rules that are proposed are meant to promote a co-operative relationship between competition authorities and state aid granters. It is proposed that decisions of the Competition Commission on state aid will not be binding but it is hoped that the status of the Commission as an impartial and sound regulator will convince government to comply with its decisions.

The problem of government's non-compliance with state aid rules nevertheless will remain a nagging problem. The solution may be imperfect but it is proposed that it is the best current solution for problems with state aid to SOEs.

2 3 2 A potential conflict between the proposed state aid rules and existing national legislation that allow state aid to SOEs

State aid legislation will not be supra-national as is the case in the EU. State aid legislation in South Africa, enacted as ordinary national legislation may conflict with other national legislation. It may be difficult to resolve these types of conflicts. However, it is also clear that state aid regimes have also been made applicable in other countries and the obstacles created by this can be surmounted. It appears that

[398] See the discussion in para 3.2 of this chapter.

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the United Kingdom will continue to have a state aid regime after Brexit,[399] Eastern European countries were required to regulate state aid before they became EU members[400] and the EU has made state aid rules a condition of comprehensive trade relationships with countries such as the Ukraine.[401]

The Constitution does not expressly deal with these difficulties. It declares its own supremacy.[402] It also regulates conflicts between national and provincial legislation as well as national legislation and a provincial constitution.[403] It does not deal with the relationship between different national statutes.

Of course statutory state aid rules will be subject to the Constitution. But constitutional supremacy will not be of special relevance in resolving the types of statutory conflicts that will arise when powers to grant state aid in one statute is restricted by state aid rules in another. It will become apparent from the ensuing discussion that guarantees granted by the state in favour of SOEs are treated as the most important form of state aid that should be subjected to regulation. The Constitution[404] grants powers to give guarantees for loans to national government, provincial government and municipalities, only "if the guarantee complies with any conditions set out in national legislation". The use of the term "may" and the qualification makes it clear that state aid regulation provisions will not conflict with the Constitution but could be viewed even as an expression of section 218. This will be particularly true of the limited state aid provisions that will be proposed here. In this sense it will merely add to the state aid provisions set out in the PFMA.[405] When the government grants the guarantees in accordance with the conditions in the PFMA[406] and publishes an annual report[407] on the guarantees it has granted for a

[399] See the discussion on Brexit in para 4 3 7 3 of chapter 3.
[400] See the discussion on the aspect in para 3 of chapter 1.
[401] See the discussion in para 2.2 of chapter 5 on the position of state aid in associated countries of the EU.
[402] Constitution of the Republic of South Africa of 1996 section 2 read with 39(2) and 172.
[403] See section 146(2) and (3) of the Constitution of the Republic of South Africa of 1996.
[404] Section 218 of the Constitution of the Republic of South Africa of 1996.
[405] See below. The state aid provisions nevertheless will have to comply with section 218(2) "National legislation referred to in subsection (1) may be enacted only after any recommendations of the Financial and Fiscal Commission have been considered".
[406] Section 66- 70 of the PFMA.
[407] This requirement is set out in section 218(3) of the Constitution.

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particular financial year, it is in compliance with what is expected from it in terms of both the PFMA and the Constitution.

It is most important for the problem at hand to consider the legal position where provisions in different national statutes are inconsistent. It is not uncommon for different legislative provisions in different national statutes to overlap or even conflict. According to the maxim *lex posterior priori derogant*, later national legislation which is inconsistent with earlier legislation will override such earlier legislation. Later legislation can override earlier legislation either expressly or by implication. Later legislation therefore will override earlier legislation even if it does not specifically refer to the earlier legislation or does not expressly determine that it will override earlier legislation.[408] One Parliament does not have the power to bind future parliaments in ordinary legislation. However, courts will be reluctant to apply the *lex posterior* maxim where later legislation revokes earlier legislation by implication.[409] There are two interpretive presumptions that steer courts in this direction. Legislation is presumed to not change the law more than is necessary. This presumption is frequently applied with regard to legislation that changes the common law but it also impacts on legislation that conflicts with earlier legislation. Furthermore, general provisions are presumed not to revoke specific provisions (*generalia specialibus non derogant)*.[410] Later, general enactments therefore will not override more specific existing legislation.

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[408] *Palala Resources (Pty) Ltd v Minister of Mineral Resources and Energy* 2014 (6) SA 403 (GP) para 53; *Khumalo v Director-General of Co-operation and Development* [1991] 1 All SA 297 (A) 301; *Darries v City of Johannesburg* [2009] 3 All SA 277 (GSJ) paras 34-35; and *City of Johannesburg Metropolitan Municipality v Gauteng Development Tribunal* 2008 (4) SA 572 (W) 54.

[409] *United Greyhound Racing & Breeders Society v Vrystaat Dobbel en Wedren Raad* [2002] JOL 10171 (O) 7; *Sasol Synthetic Fuels (Pty) Ltd v Lambert* 2002 (2) SA 21(SCA) paras 15-17; and *End Conscription Campaign and another v Minister of Defence* 1993 (1) SA 589 (T) 253.

[410] *Khumalo v Director-General of Co-operation and Development* [1991] 1 All SA 297 (A) 301; *Consolidated Employers Medical Aid Society and Others v Leveton* 1999(2) SA 32 (SCA) paras 19-20; *S v Swartz* (2) SACR 268 (WCC) 276; *Cipla Medpro (Pty) Ltd v Societe Des Produits Nestle SA* 2014 BIP 146 (GP) para 15.
The aforementioned cases, when referencing or applying this principle of statutory interpretation, recognise the long established dictum made in *R v Gwantshu* 1931 EDL 29 at 31, which followed what Lord Hobhouse stated in the Privy Council case of *Barker v Edger* 1898 AC. Gutsche J stated in *Gwantshu*: "When the Legislature has given attention to a separate subject and made provision for it the presumption is that a subsequent general enactment is not intended to interfere with the special provision, unless it manifests that intention very clearly." For further reading on the application of this maxim to the interpretation of statutes see G Devenish "The application of the *generalia specialibus non derogant* principle in the interpretation of statutes" (2005) 122(1) *South African Law Journal* 72-75.

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It may be difficult to apply these principles in determining the relationship between a national statutory instrument that allow for state aid and the national statute that regulates state aid. It is proposed that general provisions that allow for grants of state aid and are compatible with the state aid rules will in most cases have to be interpreted in a manner that allows them to be concurrently applied. This will be the case whether the enabling provision was enacted before or after the state aid regulation. Most cases of overlap will probably be resolved in this manner.

Only on rare occasion will state aid rules and enabling legislation be so clearly incompatible, that only one provision could prevail. Where enabling legislation precedes the state aid rules and are formulated in a manner which is clearly incompatible with the state aid rules, it will have to be determined whether the state aid rules were intended to override the enabling legislation to the extent necessary to enable concurrent application. If the enabling legislation follows the state aid rules, the question will be whether the enabling legislation was intended to override the state aid rules. The fact that enabling legislation precedes or follows the state aid rules would not be determinative of the relationship between the statutory provisions but it would at least impact on the manner in which the hierarchy will have to be determined.

In an attempt to resolve these types of problems, some statutes contain provisions that determine the hierarchy of legislation in cases where they are inconsistent. The Labour Relations Act for instance determines that: “If any conflict, relating to the matters dealt with in this Act, arises between this Act and the provisions of any other law save the Constitution or any Act expressly amending this Act, the provisions of this Act will prevail.”[411] The Companies Act determines that an attempt should first be made to interpret the Act and other statutes that apparently are inconsistent with it in a manner that allows for them to be applied concurrently. If this is not possible, the Companies Act will trump other statutes except for a small number of statutes listed in the Companies Act.[412] The PFMA provides that it will prevail in situations

[411] Labour Relations Act 66 of 1995 section 210.
[412] Companies Act 71 of 2008 section 5(4). See also the Consumer Protection Act 68 of 2008 section 2(8) and 2(9) which states that two Acts should in case of inconsistency be interpreted to give the greatest possible protection to consumers. See for the meaning of this provision *MFV “Polaris”: Southern African Shipyards*

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where it is inconsistent with other legislation.[413] The exact consequences of these types of statutory provisions have not yet been carefully considered in the case law. These types of provisions will provide a court with further justifications for concluding that later legislation does not override earlier legislation that is given statutory priority in the earlier legislation. The Constitutional Court has concluded that the Labour Relations Act trumped the Promotion of Administrative Justice Act in the context of employment relations even though the latter act was enacted after the former. Skweyiya J concluded that "When PAJA was promulgated, five years after the current LRA came into force, section 210 remained untouched. The Legislature, aware of the implications of this provision in the LRA, enacted PAJA without altering section 210. This is significant, in that it would appear that the Legislature intended that PAJA should not detract from the pre-eminence of the LRA and its specialised labour disputes mechanisms."[414] However, it is clear that these types of provisions cannot override later legislation that clearly conflicts with the legislation that is given preference in an earlier statute.[415] It will be proposed that a similar type of provision could be inserted in the state aid legislation, despite the limits of such legislation. Nevertheless, it will be proposed that such a priority provision should be added to the statutory provisions regarding state aid in order to further bolster their impact.

In conclusion, it is proposed that state aid statutory provisions can be enacted that will in most cases be complementary and not inconsistent with statutory powers to grant state aid. The state aid rules should explicitly contain provisions that make it clear that they should apply to all grants of state aid that fall within its ambit, irrespective of the statutory basis for those grants. This again will broaden the sphere of operation of state aid provisions, although it will not exclude the possibility that a later statute will not explicitly exclude the operation of the state aid rules from a particular grant of state aid. However, this is unlikely to occur. Most powers to grant the types of state aid that will be covered by the proposed state aid regulations

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(Pty) Ltd v MFV "Polaris" and others [2018] 3 All SA 219 (WCC) para 65; *Minister of Defence and Military Veterans v Motau and others* 2014 (8) BCLR 930 (CC) para 74. See also *Von Siebel and Others v Accentuate Limited and Others* (47008/13) [2015] ZAGPJHC 99 (13 March 2015) para 26 although this paragraph is badly formulated.

[413] Section 3(3) of the PFMA.

[414] *Chirwa v Transnet Ltd* [2008] 2 BLLR 97 (CC) para 50.

[415] *Albert Faure t/a Faure Bros & others v Marais* [1999] 7 BLLR 663 (LC) para 10.

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will be derived either directly or indirectly from the PFMA. It will in most cases be possible to apply the state aid rules concurrently with the PFMA. This will be the case even where the state aid is supported by a budget process and appropriation act as provided for in the PFMA. The PFMA determines that draft legislation to amend the PFMA can only be introduced in Parliament by the Minister of Finance or after the Minister has been consulted on the contents of the draft legislation.[416] It is contended that the proposed state aid provisions do not fall into this category and that, in any event, the PFMA as ordinary national legislation cannot determine the process by which future legislation must be enacted. Nevertheless, to remain on the safe side, it would be better to comply with these requirements. Of course future amendments of the PFMA or newly enacted enabling legislation may exclude grants of state aid from the ambit of the state aid regime, but it is unlikely that this will be done except in extraordinary circumstances.

3 A proposal of the state aid rules that could be applied to state financial aid to SOEs in South Africa and how it could be applied

3 1 To what entities should it apply?

The EU state aid rules which form the basis for the recommendations made in this study, applies to all undertakings,[417] regardless of their ownership, including public undertakings[418] and the providers of SGEI.[419] Article 106[420] of the TFEU ensures that

[416] Section 4 of the PFMA.
[417] See *Steinike & Weinlig v Federal Republic of Germany* [1977] ECR 595 where the Court of Justice stated that the treaty provisions on state aid control covers both private and public undertakings with the exemptions mentioned in what was then Article 90(2) of the Treaty on the functioning of the European Union. At present it is found in Article 106 (2).
[418] A public undertaking in the EU is described by the EU Commission as: "any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it." See Commission Directive of 25 June 1980 on the transparency of financial relations between Member States and public undertakings *Official Journal of the European Communities* 1980/L 195/35. See also *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission of the European Communities* [1982] ECR 2545.
[419] See the discussion on SGEI in para 7.2 of chapter 4.
[420] For more on this section see the discussion in para 7 of chapter 4 with the heading: "The state aid prohibition and Public Undertakings (SOEs). The EU Commission first applied article 106 in 1985 when it challenged a Greek Law which required that all public property, including the assets of Greek public undertakings, must be insured exclusively with public-sector insurance companies. The Greek law also required the staff of State-owned banks to recommend to their customers to take out insurance with an insurance company owned and controlled by the public banking sector. The Commission found that the provisions in the Greek Law which

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competition law applies to those public undertakings to which member states may have granted special or exclusive rights and those undertakings which have been entrusted with SGEI if the rules do not obstruct the performance of their particular task. Hence the state aid regime is applicable to every undertaking "engaged in economic activity, regardless of its legal personality or status, or the way in which it is financed."[421]

The implementation of state aid rules without qualification is not possible in South Africa for the reasons mentioned above.[422] It is proposed that, especially at the outset, a more careful approach should be followed in South Africa. Only a smaller number of particularly problematic firms in the form of SOEs should be included in the regulatory regime. The proposed regime should start out in a focused manner. That means that the South African regime will be narrower than its European equivalent. However, although the EU includes all undertakings within its regulatory regime, it then exempts some forms of state aid. Several entities will be excluded from the proposed regime for reasons that are similar to those that underlie exemption of activities in the EU.

It is further necessary to determine to which SOEs state aid rules should apply. Horwitz[423] divides SOEs in South Africa into three categories based on their public interest role. The first category of SOEs is those serving a *clear public interest*[424] and here SOEs such as Eskom, the SAPO and the SABC are included. Horwitz defines the clear public interest of these SOEs by the role which they play in the "provision of basic needs, essential infrastructure, or services."[425] Horwitz's second category covers those SOEs which are serving *some public interest*[426] and SAA, Armscor and Denel are listed in this category. Horwitz states that SOEs in this category have no

allowed for such restrictions to exist, were incompatible with Article 90 (1) of the EEC Treaty, which is at present Article 106 (1) of the TFEU. See Commission Decision of 24 April 1985 concerning the insurance in Greece of public property and loans granted by Greek State-owned banks *Official Journal of the European Communities* No L 152/25 (1985). See also P Sutherland "EEC Competition Policy" (1985) 54 *Antitrust Law Journal* 667 672-673.

[421] See A Jones "The Boundaries of an Undertaking in EU Competition Law" (2012) 8(2) *European Competition Journal* 301 302.

[422] See the discussion in para 2.1 of this chapter.

[423] RB Horwitz *Communication and Democratic Reform in South Africa* (2004) 357.

[424] My emphasis.

[425] RB Horwitz *Communication and Democratic Reform in South Africa* (2004) 357.

[426] My emphasis

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particular role in the provision of essential services but that they are "historically in [the] public sector for national security or strategic reasons".[427] The third category of SOEs is those serving *no public interest*[428] such as Alexkor and the South African Forestry Company (SAFCOL). According to Horwitz these SOEs had no role at all under South Africa's first development plan which was the Reconstruction and Development Programme.[429] Many SOEs have changed categories since this particular classification was made and the National Development Plan 2030 instead of the Reconstructive and Development Programme of South Africa is now the policy document which sets out the long-term aims to "eliminate poverty and reduce inequality".[430] Moreover, public interest can have a narrow or wide meaning. Is it in the public interest to maintain an SOE to protect employment? What remains the same though is that SOEs either have a "clear public interest", "limited public interest" or "no public interest" mandate.

It may be proposed that a classification of SOEs in accordance with their mandates, similar to Horwitz's classification above, could be helpful in state aid control matters. Such a classification could be used to exempt state funding to SOEs with clear public interest activities from scrutiny. However, it is submitted that such an approach will not adequately address the threat posed by state aid to competition. This is because potential harmful state aid could be given to SOEs that fall in an exempted category. The essential mandates of SOEs such as Eskom, SAPO, the SABC and PRASA will allow them to be placed in the category of those SOEs with a clear public interest role, since most of these SOEs have public service obligations similar to SGEI in the EU. Their activities have a significant impact on the daily lives of many South Africans. They benefit many South Africans, in particular those who might possibly have been excluded from the services and goods which these SOEs deliver. Yet it is these SOEs that are regularly receiving state aid which harms

[427] RB Horwitz *Communication and Democratic Reform in South Africa* (2004) 357.
[428] My emphasis
[429] RB Horwitz *Communication and Democratic Reform in South Africa* (2004) 357.
[430] The National Development Plan 2030 can be accessed on the South African government's website at http://www.gov.za/issues/national-development-plan-2030.

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competition and should therefore be condemned.[431] It would therefore make no sense to exclude these entities from the application of the proposed regulatory regime. The objective of the proposed regulatory scheme would not be achieved if any of these SOEs were to be excluded, without any qualifications, from the application of proposed state aid rules only because they have a clear public interest role.

If SOEs such as Eskom, SAPO, the SABC and PRASA would operate in the EU, they would be regarded as firms and fall within the state aid regime but their activities would most likely be classified as SGEI because of their public service obligations. On this basis at least some of the state aid provided to them would escape scrutiny in terms of the state aid regime. But in order to be classified as such, they at first would have to comply with the criteria set out in *Altmark* and the "SGEI package".[432] It is contended that these firms should in South Africa similarly fall within the state aid regime but that relief from scrutiny in terms of the proposed state aid regime should be given elsewhere.

It is therefore recommended that state aid control rules should apply to all SOEs that are regarded as firms[433] and perform commercial activities as described in the PFMA, regardless whether the SOEs have or also have a clear public interest role. As in the EU, the focus should rather be on the state aid itself, the effect of the state aid and in the contex of South Africa, the reasons why SOEs are in perpetual need of state aid to help them to continue to deliver their goods and services uninterrupted, instead of the type of enterprise. SOEs such as PRASA, the SABC and SANRAL which, at least in part have to operate in accordance with normal business practices and which are the ones regularly requiring state financial aid should be covered by the scope of state aid control rules as state aid to these SOEs allows them to maintain their position of state monopolies. However, special provision should be made for these SOEs since they are entrusted by the state to

[431] See the reference to the many Public Protector Reports of financial irregularities and even criminal conduct in para 1.2 of this chapter. See also the recent judgment of *Passenger Rail Agency of South Africa v Swifambo Rail Agency (Pty) Ltd* [2017] 3 All SA 971 (GJ).
[432] See para 7.2 of chapter 4.
[433] See the discussion in para 1.1(b) of this chapter on the term "firm" as it is defined in South African competition law.

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perform specific public service obligations similar to SGEI in the EU. It is submitted that only those SOEs, which do not conduct commercial activities and therefore do not constitute firms, which include the constitutional institutions, boards and commissions,[434] should from the outset be excluded from the application of state aid rules.

Although the focus of this proposal and this study is state aid granted to SOEs, it is recognised that state aid to enterprises which are not SOEs occurs fairly frequently. The proposals in this study are focused on state aid to SOEs because of the specific problems that it poses in South Africa and the difficulties with making proposals even in this limited context. This is a topic that will be left for future research or other researches. For the moment it is merely observed that state aid to firms that are not SOEs can also be the subject of market inquiries.[435] Moreover, this study will merely highlight some of the problems that may arise when state aid to firms that are not SOEs is evaluated.

It is generally less likely that state aid to firms that are not SOEs will serve clear public interests goals. However, there clearly will be many cases where state aid to these firms could be in the public interest. Two examples will be mentioned:

- Firstly, private enterprises could have public interest roles as part of their operations. The state could fund these public interest activities through the annual national budget. Appropriations to these private enterprises form part of the annual appropriations which are made to the government department which has oversight of the developmental programme of which the private enterprises are part. Examples of private enterprises which receive appropriations in the annual national budget includes non-grid electrification services providers, enterprises which are part of the Recycling Enterprise Support Programme, enterprises which are part of the Cooperatives Incentive Scheme for enhancing entrepreneurship and the development of small business development, enterprises which are part of the Tourism Sector Support Services and plays a role in the development of the tourism

[434] See section 1 and Schedule 1 of the PFMA respectively for a reference to boards and commission and a list of the constitutional institutions.
[435] See infra 3.3.2.

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sector to ensure South Africa is a competitive tourism destination.[436] All these private enterprise which are given appropriations in the annual national budget have one thing in common, they are all involved in particular governmental development programmes.

- Secondly, state aid may be given to prevent systemic harm to the financial system or the broader economy. In the aftermath of the financial crisis[437] in 2008, governments all over the world provided rescue aid to enterprises, in particular financial enterprises such as banks. It is clear that the financial rescue of enterprises during the financial crisis did not depend on the enterprise's ownership but on how devastating its failure would have been for its home country's economy at large. Governments of countries such as the United States and Great Britain relied on the maxim that some enterprises were "too big to fail"[438] and therefore rescued them from failure.[439] Even the EU, with its strict state aid rules, makes provision for state aid to rescue and restructure undertakings in difficulty.[440] Rescue and restructuring aid is allowed in terms of strict guidelines. The EU Commission feels strongly that the exit of inefficient undertakings forms a normal part of the operation of the market and that the rescue of undertakings which gets into difficulties should not be the norm.[441] Therefor the state aid rules are still strictly applied to failing undertakings and any deviation from the state aid rules are only allowed in limited instances.[442] Rescue and restructuring aid gave rise to some of the most controversial state aid cases and is among the most distortive types of state aid.[443] The 2008 financial crisis was one of those instances in which the EU Commission allowed a deviation from the strict application of the state aid rules but not without qualification because in its guidelines the Commission has reinforced the "one time, last time" principle, which

[436] This becomes clear from the various Appropriation Acts which were proclaimed over the years.
[437] See the concise discussion on the crisis in para 5. 3 of chapter 4.
[438] See RS Karmel "A law professor's perspective on "too big to fail" (2014) *Journal of Banking Regulation* Vol 15 (3/4) 227 -234 for more on the "too big to fail" notion.
[439] See the discussion in para 5.3 of chapter 4.
[440] See "Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty" *Official Journal of the European Union* C249/1 (2014); and" Community Guidelines on State Aid for Rescuing and Restructuring in Difficulty" *Official Journal of the European Communities* C 244 (2004).
[441] See "Community Guidelines on State Aid for Rescuing and Restructuring in Difficulty" *Official Journal of the European Communities* C 244 (2004) 2.
[442] "Community Guidelines on State Aid for Rescuing and Restructuring in Difficulty" *Official Journal of the European Communities* C 244 (2004) 2.
[443] See "Community Guidelines on State Aid for Rescuing and Restructuring in Difficulty" *Official Journal of the European Communities* C 244 (2004) 2.

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prevents repeated rescue or restructuring aid to keep ailing undertakings alive.[444] If it is in future decided to extend state aid regulations to firms that are not SOEs, then adequate provision should be made for the proper consideration of these kinds of public interest considerations. As with state aid to SOEs the effects of the aid on public interest and on competition will have to be considered and balanced in a developing country such as South Africa.[445]

3 2 To what forms of state aid should it apply?

3 2 1 Introduction

In South Africa state aid to SOEs takes many forms.[446] In the broadest sense any financial support which the state provides to SOEs is state aid. It will range from something as subtle as special tax exemptions to the giving of security, loans, purchases of shares to allocations of funds by government as "transfers and subsidies".[447] Nevertheless, it should be carefully considered whether all or only some of these forms of state aid should be covered by the proposed state regime.

The South African government grants state aid to the SOEs for a number of reasons. It could, for example, be granted:
(i) because of undercapitalisation;
(ii) to enable SOEs to borrow money, which they otherwise might not have been able to do: the SOEs thus receive governmental guarantees to make borrowing possible;
(iii) because of irregular expenditure[448] and fruitless and wasteful expenditure which cause a deficit in funds of SOEs;[449]

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[444] See Community Guidelines on State Aid for Rescuing and Restructuring in Difficulty Official Journal of the European Communities C 244 (October 2004) 2
[445] See the discussion in para 3.3.3 on the proposed responsibility for the Commission which will ensure that it takes into account public interest considerations when investigating state aid matters.
[446] See para 1.1 (c) of this chapter for the forms state aid can take.
[447] See the various annual Appropriation Acts for a definition of "transfers and subsidies".
[448] For examples of these types of spending see A Van Schalkwyk "Unauthorised, Irregular, Fruitless and Wasteful Expenditure – What Is It?" (2015) 15(4) *Official Journal of the Institute of Municipal Finance Officers* 14 14 – 16. Although the author provides examples of these types of spending in the context of municipalities, such examples can also be found on a national level. In accordance with the Auditor-General's annual report of 2015-2016, PRASA, for example, is noted as one of the "highest contributors" to excessive irregular expenditure.

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(iv) because of losses from criminal conduct such as fraud and corruption, which are rife in many of South Africa's crucial SOEs; and
(v) because of operational losses, due to external factors such as difficult trading conditions rather than failures of governance.

3 2 2 The role of the PFMA in regulating the financing of SOEs[450]

In order to determine to what forms of state aid the proposed state aid rules should apply, it is paramount to know how financial support, provided to public institutions (that include SOEs) is regulated in South Africa. In general government finances are regulated in terms of the PFMA.

A brief overview of the broad controls over funding by the national government is given here in order to provide some context for the proposals on the types of state aid that should be covered by state aid regulations. For this purpose the focus will be placed on the regulation of national finances.[451] Processes and measures[452] required by the PFMA are aimed at ensuring that there are at all times accountability and transparency where the government provides financial support to SOEs. The PFMA is not concerned with the competitive effects of the funding of SOEs but it is still relevant to an understanding of the types of state aid that should be regulated in competition law.

With few exceptions, revenues received by government will be paid into the National Revenue Fund.[453] Withdrawals may be made from this fund only in terms of an

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[449] For examples of these types of spending see A Van Schalkwyk "Unauthorised, Irregular, Fruitless and Wasteful Expenditure – What Is It?" (2015) 15(4) *Official Journal of the Institute of Municipal Finance Officers* 14 14 – 16. Although the author provides examples of these types of spending in the context of municipalities, such examples can also be found on a national level. The Auditor –General's annual report 2015-2016 identifies for example PRASA as one of the big culprits where this type of expenditure is concerned.
[450] See also the discussion on the PFMA in para 3.6 of chapter 2.
[451] The PFMA provides a system for the control of provincial funding that mirrors the provisions described here. See section 26-35 of the PFMA.
[452] Such processes include for example "effective and appropriate steps" by the accounting officers of SOEs to prevent any unauthorised, irregular and fruitless and wasteful expenditure (section 38(1) (a) of the PFMA), reporting of fruitless and wasteful expenditure immediately in writing to the relevant treasury (section 38 (1) (g) of the PFMA) and possible criminal conviction of the accounting officer if there was gross negligence in not preventing such spending (section 86 of the PFMA).
[453] Section 11 of the PFMA. See also section 213 of the Constitution of the Republic of South Africa. Provinces have Provincial Revenue Funds, see sections 21-25 of the PFMA and section 226 of the Constitution.

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annual appropriation by an Act of Parliament or as a direct charge against the fund.[454] The annual appropriation[455] will be done by reference to a national annual budget.[456]

The PFMA lists the institutions to which it applies.[457] Some institutions are mainly funded by national or provincial government from revenue funds and this includes the constitutional institutions, national and provincial public entities[458] and national and provincial departments.[459] Annual budgets explicitly provide for appropriations that should be made to departments.[460] The different national and provincial departments with oversight over constitutional institutions and the public entities transfer the funds to them from the appropriations made in the national annual budget. For example, the Department of Justice and Constitutional Development will transfer funds to the institutions over which it has oversight. These include the Public Protector, Legal Aid South Africa and the South African Human Rights Commission.

SOEs fall into a different category and because of their particular relevance, the financing of SOEs and the role which the PFMA plays in this will be discussed in the next section.

3 2 3 SOEs and their funding

SOEs are public institutions that are not supposed to receive substantial continual funding from national government or provincial governments. These institutions are fully or substantially financed from sources other than the National Revenue Fund, a tax, levy or other state funds.[461] The National Treasury regularly emphasises that

[454] Sections 11 and 15 of the PFMA. Direct charges may be made on the fund in terms of the Constitution or other legislation. For an example of a direct charge provided for in the PFMA, see section 16. For the position in the Provinces, see sections 21 and 24 of the PFMA. See also section 213 of the Constitution of the Republic of South Africa 108 of 1996.
[455] Section 26 of the PFMA and the definition in section 1.
[456] Sections 27(1), 27(3) and 27(4) of the PFMA. See also the national adjustment budget, section 30 discussed below. For provinces also see sections 27(2)-27(4). For provincial adjustment budgets, see section 31.
[457] Section 3 of the PFMA, see also section 215 of the Constitution of the Republic of South Africa.
[458] Section 1 of the PFMA; except for those public entities that are directly funded by a tax or levy determined by legislation. These entities are listed in Schedule 3.
[459] See the definitions of these terms in the section 1 of the PFMA.
[460] Referred to as vote, see PFMA s 1 and see also the definition of "main division within a vote".
[461] Section 1 of the PFMA.

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"State-owned companies generally operate without direct support from the National Revenue Fund …"[462] and that "[n]one of these public institutions should depend directly on the budget for revenue."[463] According to the PFMA this category consists of:

- "major public entities" such as Eskom and the SABC;[464]
- "national government business enterprises" such as PRASA; and
- "provincial business enterprises" such as Ithala Development Finance Corporation in Kwazulu-Natal.[465]

SOEs can obtain the funds they need to conduct their activities from various sources:

a) The equity of these firms is normally exclusively or at least substantially provided by the state;

b) They may borrow funds;[466]

c) The activities or some activities of SOEs may be subsidised by the state;

d) They may generate profits.

The profits of SOEs are realised from their business activities.[467] In some cases revenues of SOEs are generated according to normal business principles. SAA will have to compete for customers with several privately owned airlines. However, these profits may also be influenced by statutory measures that determine how revenue is earned. Eskom is regarded as having a natural monopoly and therefore the tariffs which it charges is regulated (they must be approved by the National Energy Regulator of South Africa (Nersa)). In the case of the SABC a substantial part of its revenue is raised through a licensing fee that has a statutory basis. Although these statutory provisions may be relevant to broad competition policy it is submitted that the price regulations that apply to Eskom and also the statutory fees of the SABC should not in South Africa have the effect of converting revenues into state aid.

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[462] 2018 Budget Review 93 (available at http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf).
[463] 2017 Budget Review 96 (available at http://www.treasury.gov.za/documents/national%20budget/2017/review/Chapter%208.pdf).
[464] See the list in Schedule 2.
[465] The definitions in section 1 read with the list in Schedule 3.
[466] See *National Union of Mineworkers / Eskom Holdings Soc Ltd* [2014] 5 BALR 507 (CCMA) para 36.
[467] See *National Union of Mineworkers / Eskom Holdings Soc Ltd* [2014] 5 BALR 507 (CCMA) para 36.

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The other forms of funding will have to be more carefully considered in order to establish the boundaries for state aid and its regulation in South Africa.

3 2 3 1 Subsidisation of particular activities through national and provincial budgets

During the annual budgetary process the government expends government revenue on four main categories of expenditure:[468]
(i) current expenditure, which include compensation of employees, payment for goods and service and interest and rent on land;
(ii) transfers and subsidies, which include transfers/subsidies to departmental agencies, non-profit organisations, public corporations and private enterprises;
(iii) payments for capital assets; and
(iv) payment for financial assets.

Each one of these categories is defined in the annual Appropriation Acts.[469] For purposes of this study, the "transfers and subsidies" category is important as payment made under this category could be viewed as state aid. The following table presents a list of selected[470] transfers made from the national budget of overseeing departments to some SOEs since 2008.

RAND (MILLION)	ESKOM	ALEXKOR	DENEL	SABC	SAPO
2008/9					
2009/10					

[468] See the different Appropriation Acts.
[469] Section 1 of the different Appropriation Acts.
[470] Other SOEs also received transfers. For a full list of the transfers see http://www.treasury.gov.za/publications/other/MinAnsw/2019/PQ%20302%20-%20Sarupen%20-%20NW1268E.pdf (last visited on 7 February 2020).

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2010/11	1 828 710	36 000	181 296	290 760	306 077
2011/12	1 856 610		116 255	143 800	180 442
2012/13	1 879 368	350 000	118 313	215 444	
2013/14	2 141 027		57 250	256 570	
2014/15	2 948 037			227 168	50 000
2015/16	3 613 243			172 927	115 092
2016/17	3 526 334			182 093	240 000
2017/18	3 846 154			173 766	240 000
2018/19	3 262 031			187 421	

Source*: National Treasury's reply to written questions by an MP*[471] *and the different Appropriation Acts*

The National Treasury states that funds which are transferred from a department's annual budget to another entity in order for the entity to further its operations in line with the entity's mandate are classified as "transfers and subsidies".[472] It is clear from treasury documents[473] that these "transfers and subsidies", as defined by the Treasury and allocated in Appropriation Acts, are always related to the SOEs governmental mandate. Departments with oversight of SOEs will have certain strategic development plans and in order to achieve those plans, it will provide subsidies and transfers to various entities including SOEs. These subsidies are given to SOEs in terms of the national or provincial budgets to allow them to conduct specific activities that will not be performed according to ordinary business principles. Although National Treasury accepts that SOEs should be able to operate without continual reliance on the National Revenue Fund it acknowledges that "in some cases their enabling statutes provide for contributions from appropriated funds".[474]

[471] See http://www.treasury.gov.za/publications/other/MinAnsw/2019/PQ%20302%20-%20Sarupen%20-%20NW1268E.pdf (last accessed on 7 February 2020).
[472] National Treasury's "Classification Circular- Classification of Transfers and Subsidies versus Goods and Services or Capital Assets" (available at oag.treaury.gov.za).
[473] See the Consolidated Financial Statements (CFS) which are issued by the National Treasury after the end of each financial year.
[474] 2018 Budget Review 93
(available at http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf).

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Consecutive annual budgets (including the most recent one), for instance, make provision for transfers and subsidies to SOEs which are operated in accordance with normal business principles. The transfers and subsidies which are made to these SOEs form part of the appropriations made to the government department which have oversight over these institutions. PRASA, for example, is subject to the oversight of the Department of Transport.[475] This department's development plans include investing in road infrastructure, upgrading rail infrastructure and services and building as well as operating public transportation infrastructure.[476] Many of these development plans are executed by SOEs: SANRAL executes the development plans in regard to road infrastructure and PRASA executes the development plans in regard to the upgrading of rail infrastructure. In order to achieve these objectives the Department of Transport will provide subsidies and transfers to the SOEs.[477] Hence, an SOE such as PRASA has been receiving subsidies and transfers for rail maintenance operations as well as to refurbish coaches and signalling. Other examples of SOEs which have received such "transfers and subsidies" in the past are SAA, which received transfers and subsidies from either the Department of Public Enterprises or the National Treasury (while it was still under the supervision of the Treasury). SAA was until recently under the oversight of the National Treasury but has now been transferred back to the supervision of the Department of Public Enterprises.[478] With regard to SA Express the Department of Public Enterprises made such transfers and subsidies.[479]

In Europe these forms of funding would constitute state aid but could be excluded from scrutiny in terms of the state aid rules if the *Altmark* criteria are fulfilled or the state aid could be exempted in terms of the "SGEI package".[480] It is therefore proposed that these types of funding in South Africa should also be awarded special

[475] Para 35 of the Appropriation Act of 2018. See also para 35 of the Appropriation Act of 2019.
[476] See for instance The Consolidated Financial Statements (CFS) which are issued by the National Treasury after the end of each financial year. The CFS's shows the transfers and subsidies national departments make to certain entities.
[477] See the Consolidated Financial Statements (CFS) which are issued by the National Treasury after the end of each financial year.
[478] On 1 August 2018 SAA has been removed from the supervision of the National Treasury and returned to the supervision of the Department of Public Enterprises where it previously was. See Proclamation No 23 of 2018 by the President of the Republic of South Africa on the "Transfer of Administration, Powers and Functions entrusted by the South African Airways Act, 2007" in *Government Gazette* 41815 (1 August 2018) Vol 638.
[479] Para 9 of the Adjustments Appropriations Bill of 2018.
[480] See the discussion on SGEI in the EU in para 7.2 of chapter 4.

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treatment. However, it is envisaged that the special treatment should take a somewhat different form in South Africa. Even if it is accepted that these forms of support should be state aid there should be a presumption that it is in the public interest and therefore should not be subject to scrutiny by competition authorities.

3 2 3 2 Loans and credit obtained by SOEs

Subject to the PFMA, most SOEs have borrowing powers in accordance with their enabling legislation.[481] Borrowings may take various forms. It has been stated that Eskom, for instances, raises credit from domestic money markets, domestic and international markets, development finance institutions and export credit agencies. Various distinctions can be drawn for this purpose:

- Loans can be short-term or long-terms loans.[482]
- Borrowing can be from domestic and/or foreign lenders. Foreign credit for particular projects may also be obtained from international organisations such as export credit agencies and the World Bank. Eskom, for example, has been a recipient of loans for certain projects from the World Bank.[483] Domestic lenders may include commercial banks, state-owned development finance institutions such as the Land Bank, the Development Bank of Southern Africa and the Industrial Development Corporation.[484] State-owned development finance institutions are described as "a financial intermediary that aims to improve social welfare, by lending to priority

[481] Section 7 of the South African Airways Act 5 of 2007 regulates SAA's borrowing powers; section 5 of the South African Express Act 34 of 2007 regulates SA Express's borrowing powers; section 5 of the Broadband Infraco Act 33 of 2007 regulates Infraco's borrowing powers; section 7 the Eskom Conversion Act 13 of 2001 regulates Eskom's borrowing powers; Section 23 of the Broadcasting Act 4 of 1999 regulates the SABC's borrowing powers.

[482] See for example section 7 of the Eskom Conversion Act 13 of 2001, which allow Eskom to borrow from private lenders and section 7 of the South African Airways Act 5 of 2007, which sets out SAA's borrowing powers.

[483] See "South Africa's Eskom granted World Bank loan for coal plant" *Power Engineering International* (2010) 18(5) 12 12. See also "Eskom Power Investment Support Project" (available at http://projects.worldbank.org/P116410/eskom-investment-support-project?lang=en); and M Sadiki *Financial Assistance to State-Owned Enterprises by the State in South Africa: A Case Study of Eskom* MA (Public Administration) University of South Africa (2015) 1 63.

[484] The 2017 Budget Review noted that in 2016 the Land Bank helped hundreds of black farmers increase cultivation; the Development Bank of Southern Africa supported energy, roads, water and sanitation projects benefiting about 2 million urban households; and the Industrial Development Corporation approved 180 transactions valued at R14.5 billion.

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sectors or target clientele while benefiting from some level of concessionary resources received from the state and/or donors."[485]

- Most importantly for state aid purposes, a distinction can be drawn between loans or credit provided by state institutions and the private sector. Loans that are not given directly by the state will not constitute state aid. The Public Investment Corporation, for instance, held about R85 billion in Eskom bonds in early 2018.[486] It is proposed that loans given on normal business terms by public institutions that are in the business of providing credit or investment should not be regarded as state aid. In a small economy such as South Africa it will not be unusual for other SOEs and especially major public entities to also borrow from particular SOEs. However, it is proposed that loans that are given to SOEs from other government or government-related sources should be covered by the state aid provision.

3 2 3 3 The government acquires equity in SOEs

Where National or Provincial Revenue Funds are used to obtain or increase equity in the form of shares or similar securities in SOEs, it should be regarded as state aid in terms of the proposed provisions. However, it should not be state aid where equity is merely acquired on ordinary business terms from SOEs that provided it in the ordinary course of their business. If recapitalisations are not loans made by the government to the SOEs, it will be made in return for equity.[487] This is in light of the National Treasury's definition of recapitalisations. It defines recapitalisation as the "injection of funds into a company or entity to aid liquidity, either as a loan or in return for equity.[488] Therefore, if the funding comes from the National or Provincial Revenue Funds and if it is not indicated as being a loan in the ordinary course of business, the examples of recapitalisations below will constitute state aid which will be within the scope of the proposed state aid rules.

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[485] J Yaron "State-Owned Development Finance Institutions (SDFI): The Political Economy and Performance Assessment" (2006) 30(1) *Savings and Development* 39 39.
[486] http://www.gepf.co.za/index.php/news/article/gepf-invests-responsibly (last accessed 2019/03/15).
[487] See for example the Eskom Subordinated Loan Special Appropriation Amendment Act (2008/09-2010/11 Financial Years) of 2015.
[488] See the definition section in the Budget Review of 2018 179.

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- In an adjustment budget[489] in 2017 "specific and exclusive" appropriations for debt obligations and recapitalisation was made in favour of SAA,[490] a major public entity. The recapitalisation of SAA on at least two occasions in 2017 involved the provision of R10 billion to redeem maturing debt and provide working capital. In July 2017 a transfer of funds from the National Revenue Fund to SAA was made to prevent default in regard to a debt owed to Standard Chartered Bank as government wanted to avoid the triggering of the government guarantee which it had given in favour of the airline.[491] Another transfer of funds was made in September 2017 to avoid a similar difficulty concerning debts owed to Citibank.[492]
- In an adjustment budget in 2018 a "specific and exclusive" appropriation was made to South African Express, another major public entity;[493]
- According to the 2018/2019 Medium Term Budget Policy Statement,[494] SAA received R5 billion through a special appropriation statute to settle debt that have to be redeemed before March 2019, South African Express were to receive an additional R1.2 billion and the South African Post Office R2.9 billion.

SAA was therefore funded on a number of occasions to help it to meet some of its financial obligations as they become due.[495] The Budget Review of 2018 made clear that the National Treasury would recapitalise SAA to allow it to implement its long-term turnaround strategy.[496] Such assistance would entail the granting of funding support to the airline. Although SAA remains technically insolvent, as noted in the Budget Review 2018, the provision of working capital by the National Treasury is allowing the airline to continue as a business concern. However, it is proposed that these motivations for granting state aid should be investigated once the state aid is notified to the Commission, rather bases for determining what constitutes such aid.

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[489] See PFMA, section 30 on adjustment budgets and the fairly narrow grounds on which adjustment budgets may be tabled.
[490] See para 7 of the Adjustment Appropriation Bill of 2017.
[491] See the media statement "Recapitalisation of the South African Airways" (available at http://www.treasury.gov.za/comm_media/press/2017/2017070101%20SAA%20recapitalisation.pdf
[492](http://www.treasury.gov.za/comm_media/press/2017/2017100201%20MEDIA%20STATEMENT%20-%20SAA.pdf).
[493] See column 9 of the Adjustment Appropriation Bill of 2018.
[494] See PFMA, section 28 on multi-year budget projections.
[495] Examples in this regard include the funds transfer by the National Treasury to SAA in July 2017 to pay back its debt to Standard Chartered Bank and again in September 2017 to pay back its debt to Citibank. See the Budget Review of 2018 102.
[496] SAA has been a beneficiary of aid to provide working capital on many occasions. See the Budget Review of 2018 102.

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The following table presents a list of selected[497] recapitalisation fund tranfers granted to some of South Africa's biggest SOEs which are classified by the PFMA as "major public entities" since 2008.

RAND (MILLION)	ESKOM	BROADBAND INFRANCO	DENEL	SAA	SAPO	SA EXPRESS
2008/9	10 000 000	377 000				445 000
2009/10	30 000 000	208 530		1 549 080		
2010/11	20 000 000	138 600				
2011/12						
2012/13			700 000			
2013/14						
2014/15						
2015/16	23 00 000					
2016/17					650 000	
2017/18				10 000 000	3 700 000	
2018/19	5 000 000			5 000 000	2 947 000	1 249 000
2019/20	26 000 000					

Source: *National Treasury's reply to written questions by an MP*[498] *and the different Appropriation Acts*

3 2 3 4 Guarantees and other security given to creditors of SOEs by the state

[497] Other SOEs not mentioned in the table also received recapitalisation funds. See http://www.treasury.gov.za/publications/other/MinAnsw/2019/PQ%20302%20-%20Sarupen%20-%20NW1268E.pdf (last visited on 7 February 2020).

[498] See http://www.treasury.gov.za/publications/other/MinAnsw/2019/PQ%20302%20-%20Sarupen%20-%20NW1268E.pdf (last accessed on 7 February 2020).

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The most pervasive form of support which the government provides to SOEs is in the form of security for loans or other credit provides to SOEs. These securities are commonly given in the form of government guarantees. Government guarantees allow SOEs to borrow from lenders and on terms that otherwise would not have been open to them, because of their weak financial positions. The following table presents a list of guarantees which were put in place for some of South Africa's biggest SOEs for the last decade (2010-2019).

Rand (Million)	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
ESKOM	67 057	77 230	103 523	125 125	149 944	174 586	202 825	244 678	294 713
SAA	1916	1300	2238	5010	8419	14 394	17 819	11 059	17 311
SABC	1000	889	167	—	—	—	—	—	—
SA EXPRESS	—	—	—	539	539	539	827	867	163
SAPO	—	—	—	—	270	1270	3979	400	—
PRASA	468	264	133	92	48	2	—	—	—
TELKOM	90	85	90	111	100	128	108	111	125

Source: *Table 11 of the statistical annexure in the Budget Review of 2019*

The granting of government guarantees and other similar forms of security are extensively regulated. National Treasury defines a guarantee as "a commitment to take responsibility for a loan in the event of default. It enables the beneficiary to access funding that would otherwise be unavailable, or to borrow at a lower cost."[499]

[499] Budget Review (2018) 90

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Section 218 of the Constitution allows the government to guarantee loans after the conditions for such guarantees have been set out in national legislation. Section 70 of the PFMA sets out such conditions. Section 70(1)(a) establishes that:

"A Cabinet member, with the written concurrence of the Minister (given either specifically in each case or generally with regard to a category of cases and subject to any conditions approved by the Minister), may issue a guarantee, indemnity or security which binds—

(a) the National Revenue Fund in respect of a financial commitment incurred or to be incurred by the national executive".[500]

Section 70(2) provides that a payment under such a guarantee or security "is a direct charge against the National Revenue Fund, and any such payment must in the first instance be defrayed from the funds budgeted for the department". Section 70(4) requires that the relevant "Cabinet member must at least annually report the circumstances relating to any payments under a guarantee … or security… to the National Assembly for tabling in the National Assembly". But the Constitution in section 218(3) requires that "Each year, every government must publish a report on the guarantees it has granted".[501]

Although the PFMA does not explicitly require that guarantees must be given through the budgetary process, the court in the Comair case concluded that:

"The crux of Comair's argument in this specific context is that the minister's decision bypasses the various safeguards inherent in the parliamentary appropriation procedure, as they put it. The Minister of Finance (Minister P Gordhan, as he then was) said that s 70(4) of the PFMA expressly provides for the manner in which parliament was required to oversee decisions taken in terms of s 70. Any guarantee cannot and does not circumvent parliament. It is a measure authorised by constitutionally enabling legislation. A guarantee in terms of s 70 is demonstrably not intended to bypass the ordinary budget process. Any direct funding given to SAA is subject to the same parliamentary oversight as any other".[502]

(accessible at http://www.treasury.gov.za/documents/national%20budget/2018/review/Chapter%207.pdf).

[500] See PFMA section 70(3) on the requirements where consent from the Minister of Finance is required.

[501] For a comprehensive discussion on the position in regard to government guarantees and SOEs see *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 27.

[502] *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 37.

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Perhaps the rules for the granting this form of aid do not bypass the budgetary process in terms of which Parliament appropriates funds that are expended by government. However, it may be argued that it sets adequate requirements for commitments that can have severe consequences both for government finances and for the competitors of SOEs.

The major procedural hurdle for the granting of a guarantee will in terms of section 70 of the PFMA be the written consent of the Minister of Finance. As the granting of a guarantee does not entail actual expenditure until it is called upon, it will not be allocated to the budgeted expenditures of any government department and will not be reflected in an appropriation act. Outstanding guarantees nevertheless will be reported in Budget Reviews.[503] The Budget Review of 2018/2019 shows that the government guarantees in place for SOEs amounts to R529.4 billion, with SAA, SAPO, SAA Express and Eskom all beneficiaries in terms of the guarantees. It is projected that the guarantees in place will reach R879.6 billion on 31 March 2019.[504] An existing guarantee, with SAA as the beneficiary, was the reason why Comair instituted legal action against the South African government. This case is discussed above in this chapter[505] and it suffices to state here that Comair as a competitor of SAA wanted to be awarded the opportunity to make representations to the government prior to the taking of the guarantee decision.[506] It viewed the granting of the guarantee without giving them an opportunity to be heard, as procedurally unfair and in breach of their legitimate expectations.[507] However, this mere reporting requirement means that Parliament has limited control over the granting of this aid. The granting of guarantees is not subject to the same strict requirements as expenditures that do not have the same potential for harm. Section 70(4) provides stricter rules where a creditor calls on a guarantee. Here reporting to Parliament is required. However, this requirement will be tantamount to closing the stable door after the horse has bolted. It does not give Parliament any powers to address the granting of the guarantee.

[503] *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 28.
[504] Budget Review 2019 78.
[505] See para 1.1 (c) of this chapter.
[506] *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 2.5.
[507] *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 3.3.

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Although the granting of a government guarantee is not “direct funding”, the Comair case illustrates why there is a need for guarantees to be covered by the scope of any proposed regulatory measures. Although a guarantee is only a contingent liability, it remains a tangible benefit which can be the difference between failure and success for SOEs, because it allows them to borrow money at all or in some case at lower rates. To that end it ensures that SOEs will always continue as business entities while any private competitor who might encounter similar problems might not be able to obtain loans at all or at competitive rates and as a result might have to exit the market. This justifies its inclusion under any regulatory state aid measures.

3 2 3 5 Conclusion

The major forms of state aid that have been granted in the past will be covered by the proposal in this thesis. Nevertheless, it is recognised that on this proposal some forms of distortive state aid could escape regulation. It will even be possible for SOEs and government to circumvent regulation of harmful state aid through careful planning and the careful drafting of corporate plans. However, it is concluded that this proposal, albeit considerably narrower than its EU equivalent, would be more appropriate and palatable in South Africa. This proposal will contribute significantly to free and fair competition between SOEs and their private competitors, since the body responsible for ensuring free and fair competition in South Africa will now have a role to play in regard to certain state funding.

3 2 4 Other bases for determining whether particular forms of assistance to SOEs should be state aid

Certain other criteria for determining whether forms of financial support should be state aid for purposes of the proposed state aid regime have been considered and rejected for reasons that will be set out below.

3 2 4 1 State aid to address irregular, fruitless and wasteful expenditure and fraud

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Fraud, irregular, fruitless and wasteful expenditures might be a reason why SOEs require government funding. It may be argued that these practices will only be contained if government support to address them is made subject to scrutiny. It may therefore be suggested that financial support by government to address losses brought about by these types of practices should be regarded as state aid.

Recent investigations at Eskom show the extent to which SOEs were used to commit fraud.[508] There is no doubt that government support will at least to some extent have to address losses caused by fraud.

In terms of the PFMA irregular expenditure means any expenditure "incurred in contravention of or that is not in accordance with a requirement of any applicable legislation".[509] In essence there is thus a contravention of legislation where irregular expenditures are incurred.[510] Examples of irregular spending include that (i) competitive bidding methods are not being followed for the appointment of a supplier, (ii) procurement is not in line with relevant procurement policies legislation; and (iii) payment was made to a supplier without a contract.[511] Fruitless and wasteful expenditure means expenditure "which was made in vain and would have been avoided had reasonable care been exercised.[512] Fruitless and wasteful expenditure may result from a "simple oversight in performing an administrative task"[513] The oversight may be due to (i) failed internal processes and systems and (ii) human error.[514] Fruitless and wasteful expenditure may also arise due to (i) lack of planning,

[508] See "Final Report: Forensic Investigation into Various Allegations at Transnet And Eskom" (November 2018)
Available at http://www.treasury.gov.za/comm_media/press/2018/Final%20Report%20-%20Fundudzi%20-%20Eskom%2015112018.pdf.
[509] Section 1 of the PFMA.
The legislation referred to includes the PFMA, the State Tender Board Act No 86 of 1968 and any provincial legislation providing for procurement procedures in the provincial government.
[510] See para 8 of the National Treasury Updated Guidelines on Irregular Expenditure of April 2015.
[511] These were all examples of irregular spending within PRASA. See the PRASA Annual Report 2015-2016 133 (accessible at https://www.prasa.com/Annual%20Reports/Prasa%20Annual%20Report%202015-16.pdf).
[512] Section 1 of the PFMA.
[513] See the National Treasury Guidelines on Fruitless and Wasteful Expenditure of May 2014(accessible at http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf).
[514] See for example W Mtshali & Z Ntolosi "Serious Financial Problems" (2014) 14(4) *Official Journal of the Institute of Municipal Finance Officers* 24 24-26 where the authors argue for certain software system to be implemented in order to limit irregular and fruitless and wasteful expenditure.

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(ii) uninstalled hardware, and (iii) failure to follow processes during the dismissal of an executive.[515]

The PFMA requires that SOEs report on these matters. Their annual reports must include particulars of (i) any material losses through criminal conduct and any irregular expenditure and fruitless and wasteful expenditure that occurred during the financial year; (ii) any criminal or disciplinary steps taken as a consequence of such losses or irregular expenditure or fruitless and wasteful expenditure; and (iii) any financial assistance received from the state and commitments made by the state on behalf of the SOE. Through the aforementioned statutory provisions the government gets a clear indication of the financial position of SOEs and whether there might be a requirement for state funding at any point during a particular financial year.[516]

Themba Godi, the former Chairman of the Standing Committee for Public Accounts, was right when he said: "[we] all should have a sense of national responsibility when dealing with public finances."[517] It is no secret that such responsibility is absent in a number of SOEs, considering the money lost due to fraud and spent as irregular, fruitless and wasteful expenditure, as reflected in consecutive annual reports of the Auditor-General.[518] The Auditor-General's reports reflect a clear failure in SOEs to address these types of expenditures. They increase nearly every year as the latest Auditor-General report has shown.[519] These types of expenditures may firstly, result in a shortfall of funds which are available for SOEs to deliver their required mandates and secondly, it may affect the funds available to conduct commercial operations. Any shortfall of funds which are due to irregular, fruitless and wasteful expenditure could be avoided through proper corporate and financial governance.

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[515] This was the instances which PRASA, for example listed as such expenditure. See the PRASA Annual Report 2015-2016 133
(accessible at https://www.prasa.com/Annual%20Reports/Prasa%20Annual%20Report%202015-16.pdf).
[516] PFMA section 55(2).
[517] "South Africa: Parliament on Passenger Rail Agency of South Africa's irregular expenditure." *Mena Report* 25 February 2016 *Academic OneFile* http://link.galegroup.com.ez.sun.ac.za/apps/doc/A444275302/AONE?u=27uos&sid=AONE&xid=f2135eaf (accessed 7 September 2018).
[518] All reports from the Auditor-General can be accessed on its website: www.agsa.co.za.
[519] The latest report by the Auditor-General can be accessed on its website: www.agsa.co.za.

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The government, however, will not allow SOEs to suspend their mandates or their commercial operations in the event that there is a shortfall of funds due to these types of expenditures. Consequently, the government frequently steps in to ensure that SOEs firstly, continue to deliver their goods and services uninterrupted to South Africans and secondly, continue to operate their commercial activities. However, since irregular, fruitless and wasteful expenditures are always the result of governance failures, it is even more compelling that state aid due to these types of expenditure comes within the ambit of any state aid control regulation. Nevertheless, it will not be easy to make a clear determination in advance whether further state aid to SOEs is required because of fraud, irregular, fruitless or wasteful expenditure. It is therefore proposed that the existence of forms of governance failures should rather be taken into account in the evaluation of state aid by the Commission.[520]

3 2 4 2 Should funding provided by government to make good operational losses automatically be included as state aid for purpose of the state aid regime?

In recent years many SOEs have racked up large operational losses. As in the case of SAA, SOEs frequently require funding to address these losses. These losses could be the result of "the failure of people, processes and systems, and from external factors".[521] It could be argued that government financial support to address losses caused by governance failures should automatically be subject to scrutiny in terms of the state aid regime, in order to promote better governance of SOEs.

It will be clear from the above statement that operational losses are not necessarily the result of governance failure. Operational losses also may be brought about by market circumstances. An SOE such as PRASA may suffer losses because of a reduction in passenger numbers,[522] while SAA may suffer losses due to flying unprofitable or loss making routes and the SABC may suffer losses due to unpopular broadcasting content which may lead to advertisers ending or limiting their relations

[520] See the discussion in para 1.2 of this chapter.
[521] I Moosa & L Li "The frequency and severity of operational losses: a cross-country comparison" (2013) 20(2) *Applied Economics Letters* 167 167.
[522] See "Funding crisis hits home" (2010) 166(10) *Railway Gazette International* 30 30.

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with the broadcaster. State aid as a result of difficult trading conditions might impact on competition in that it keeps the playing field uneven: while private competitors will have to find ways to reduce and counter operational losses, the mandates of SOEs basically guarantee that, even when they are recording substantial operational losses, state aid will be granted by the government to enable the SOEs to continue to provide their services and goods. Additional funds for operational losses caused by difficult trading conditions will thus inevitably prolong the existence of an uneven playing field between SOEs and their private competitors. In some situations state aid in this form could be justified but these types of state aid should at least be scrutinised in terms of the state aid regime.

However, operational losses may be caused by insufficient funding by the state of public mandate activities. SAA may be forced to fly unprofitable routes to promote the integration of South Africa into the broader African economy, without support from government to fund this. It would make sense to include funding for failures of governance or even pure operational losses but not failures due to this, as these types of activities might in any event require government funding.

Again it may in practice be too difficult to determine when financing falls into the categories that would justify scrutiny as mentioned above. Therefore it is proposed that these matters should be taken into account when evaluating conduct that has been classed as state aid on other bases.

3 2 4 3 Should government funding be excluded from the state aid regime if it has been approved through the ordinary budgeting processes?

Finally, it may be argued that financing that is given through the ordinary budgetary processes, should not be subject to the state aid regime as:
1) It will already have been properly vetted;
2) The institutions that will have decided that it should be provided will be democratically elected and will represent the will of the people.

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It will be clear from the discussion above that the PFMA attempts to ensure that funding of SOEs take place by means of carefully planned processes.[523] Apart from what has already been said about budgetary processes and the financing of SOEs, references can also be made to the role which section 52 and 55 of the PFMA plays in establishing proper scrutiny for the funding of SOEs.

Section 52 of the PFMA helps the government to assess the potential requirement for any state funding by SOEs. It also helps the government to assess the borrowing requirement of each SOE. Because of section 52 the government will be fully informed whether it might have to guarantee any borrowing for SOEs during a particular financial year[524] or have to do recapitalisations. The section requires all SOEs listed in schedule 2 of the PFMA and government business enterprises, which include for example SAA, South African Express and Infraco Broadband Ltd, to submit at least one month or another period agreed with the National Treasury, before the start of its financial year-

(*a*) a projection of revenue, expenditure and borrowings for that financial year in the prescribed format;

(*b*) a corporate plan in the prescribed format covering the affairs of that public entity or business enterprise for the following three financial years, and, if it has subsidiaries, also the affairs of the subsidiaries.[525]

Section 55 of the PFMA assists the government with any assessments of a potential requirement for state funding or the potential borrowing requirements of the SOEs. In terms of this section SOEs have to submit their annual report and financial statements to the National Treasury. The annual report and financial statements must fairly present:

(i) the state of affairs of the public entity;

(ii) its business;

(iii) its financial results;

(iv) its performance against predetermined objectives; and

[523] See the discussion in para 3.2.3.1 of this chapter.

[524] The medium-term borrowing requirement of selected SOEs such as SAA, Eskom, Transnet are estimated in the annual Budget Review of the National Treasury.

[525] Section 52 of the PFMA.

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(v) its financial position as at the end of the financial year concerned.

It may therefore be proposed that only financing provided outside of clear and normal budgetary scrutiny should receive scrutiny in terms of the state aid regime. Examples would be financing through emergency powers[526] in terms of section 16 of the PFMA, a special appropriation statute,[527] an adjustment budget in terms of section 30 of the PFMA,[528] or a guarantee in terms of section 74 of the PFMA.[529] However, it is proposed that the ordinary processes have thus far not led to proper consideration of the consequences of state aid. It is therefore proposed that this should not be a basis for excluding state aid. However, the importance of giving effect to the decisions of democratically elected institutions has motivated the more limited proposal that the state aid regime in South Africa should merely grant the Competition Commission advisory powers. It is suggested that this would give better effect to the concern that the Competition Commission should not be allowed to override democratically elected institutions.

It may also be proposed that financing of SOEs provided through ordinary budgetary processes should not necessarily be excluded from scrutiny, as long as it is covered by another criterion for inclusion but, at least, that financing provided by government outside of ordinary budgetary processes should always be included in the state aid regime. A strong position on this notion is not taken in this study. However, it is ultimately concluded that the types of state aid that will be problematic if given outside of ordinary budgetary processes will be adequately covered by the criteria for inclusion that have been developed above.

3 3 The structure and operation of the proposed state aid regime for South Africa

In this part the structure and operation of the proposed state aid regime will be set out in detail and the following issues will be investigated:

[526] See the discussion in para 3.3.2.2 of this chapter on the impact of emergency powers.
[527] See for example the Eskom Special Appropriation Act of 2015.
[528] See the discussion in para 3.2.3.3 of this chapter.
[529] See the discussion in para 3.2.3.4 of this chapter.

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- The authority that should be responsible for evaluating state aid;
- How proceedings by the authority responsible for evaluating state aid should commence;
- How state aid will be evaluated by the relevant authority and what the effect of decisions of the responsible authority will be.

3 3 1 Who should evaluate state aid?

It is proposed that the Competition Commission be given a role when state aid as defined above is granted to SOEs.[530] The principal responsibility of the Competition Commission is to be the guardian of competition in South Africa. This study has shown that there can be no doubt that certain state aids are distortive. It is therefore not unreasonable to suggest that the Competition Commission should play a central role in state aid matters. Furthermore, a more active role by the Competition Commission in state aid matters was recently alluded to by the Commissioner of the Competition Commission, Thembinkosi Bonakele. It was reported that Mr Bonakele among other things stated "There should be a clear competition policy on state-owned enterprises which addresses, among other things, transparency in pricing, cross-subsidisation and bailouts."[531] These words by the highest ranked official of the Competition Commission show that even within the Competition Commission there are concerns about the impact of state aid on the competitive process. Mr Bonakele clearly envisaged the positive role which the Competition Commission could play in addressing these matters.

Outside of exemptions in terms of section 10 and small and intermediate mergers in terms of section 13 and 14(1) of the Competition Act, the Competition Commission is an investigative and prosecutorial rather than an adjudicative body. In this sense the Competition Commission has more limited powers than the EU Commission and the competition authorities of most member states. However, it is submitted that the more limited powers proposed here would be wielded more effectively by the

[530] See para 1.1 of this chapter for the discussion on the harm which state aid may cause to the competitive process.
[531] https://www.fin24.com/Economy/competition-policy-on-soes-must-be-clear-commissioner-20170831 (accessed on 2 April 2019).

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Competition Commission. It will become apparent that the proposed powers of the Commission in the context of state aid are more akin to those that it will exercise in the context of market inquiries.[532] It would overcomplicate and delay effective state aid decisions if the more formally judicial Tribunal were to become involved. When the Commission considers state aid its processes will be subject to review by the Tribunal and the Tribunal should have the power to decide whether a particular matter concerns state aid, but beyond that the Tribunal should not be involved in state aid investigations and decisions.

South African policymakers will certainly question why the competition authorities which were created to investigate anti-competitive practices and regulate mergers, should get involved in government matters or political decisions such as the granting of state aid. The competition authorities already have a wide mandate. It is necessary that priority be given to the most egregious harms to competition. Lowe[533] correctly states that:

> "The system [a modern competition policy and enforcement system] should allow the competition authority to concentrate its limited resources on specific priorities. The authority must be able to determine those priorities on the basis of the expected direct and indirect effects of its action. The system should make it possible to concentrate resources on the potentially most harmful conducts and on precedent-setting cases. This depends crucially on knowledge of markets and the capacity to focus on key issues without the need for repetitive in-depth investigations on individual cases."

Any expectations placed on competition authorities should be limited to what is realistic. Their main focus should be the regulation of anticompetitive behaviour and mergers.

[532] See the discussion in para 3.3.2.1 of this chapter.
[533] P Lowe "The Design of Competition Policy Institutions for the 21st Century-The Experience of the European Commission and DG Competition" (2014) 10 *Competition Policy International* 346 348.

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However, it has to be noted that firstly, the constraints placed on the competition authorities by their mandate and resources do not necessarily mean that they cannot evaluate potential distortive state aid. Ultimately, the mandate of the competition authorities is to protect competition generally. An active role by the guardians of competition in the granting of potential distortive state aid, will reassure existing competitors of the SOEs and also those who are considering entering markets in which SOEs are operating, that free and fair competition by SOEs is considered to be important within all sectors of the economy. In *Comair Limited v Minister of Public Enterprises*[534] the applicant (Comair) attacked the decision of the Minister of Finance with reference to the "anti-competitive conduct, unfair advantages created by the impugned decision, inequality in the market, distortion of the market, SAA's dominance, anti-competitive effects, including price predation, dumping of excess volume, poaching of passengers, and the need for pro-competitive conditions for maintaining and protecting competition in the industry". The court stated that: "Any reliance on market distortion and anticompetitive behaviour must be dealt with in terms of the provisions of s 65(2) of the Competition Act. This court cannot entertain it. I will therefore not take any such allegations and references to concepts which fall within the ambit of the Competition Act into account, when determining whether or not Comair has established the cause of action relied upon."[535] In essence, even while dealing with state aid (the government guarantee), the court was clear that it would not have the jurisdiction to hear the matter if Comair was solely relying on issues which the competition authorities have to investigate and determine from a factual and legal point of view as the Competition Act "does not contemplate concurrent jurisdiction." The court thus viewed the competition authorities as the appropriate forum to adjudicate the matter should Comair only have relied on allegations of market distortion and anticompetitive behaviour resulting from the decision to grant the guarantee. It only continued to adjudicate the matter because Comair also relied on provisions of the Promotion of Administrative Justice Act 3 of 2000 (PAJA) and the principle of legality. The court was of course wrong to think that competition matters arising from the granting of the guarantee could have been dealt with head-on by the competition authorities. This is because South Africa's

[534] *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) paras 24-26. See the discussion in para 1.1 (c) of this chapter.
[535] *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 26.

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competition law at present does not provide for the investigation, assessment and adjudication by the competition authorities of the anticompetitive consequences of state aid in any form. The court was however correct to assume that the competition authorities should have some role in regard to the anticompetitive effects of state aid.

Secondly, any concerns that a role by the competition authorities in state aid matters would place them in a dominant position over other governmental authorities who have oversight over SOEs and as a result make them "super regulators" are misguided in the light of the limited proposals made here. The Competition Act clearly sets out the relation between the competition authorities and other regulators with regard to competition matters.[536] The Commission is entitled by the Competition Act to participate in the proceedings of any regulatory authority[537] or to provide advice to any regulatory authority,[538] but the Act does not allow the competition authorities to force other regulators to act in a certain way, unless the government is acting as a firm. The new market inquiry provisions in the Competition Amendment 18 of 2018 will strengthen the Commission's position in regard to other regulatory authorities to some degree. The Commission will be allowed to investigate sectors of the economy over which a regulatory authority has jurisdiction in terms of a public regulation and may make recommendations to the regulatory authority in respect of competition matters on conclusion of an inquiry.[539] However, it remains a reality that the competition authorities cannot and will not interfere with those actions which other regulators take in their capacity as part of the executive arm of the government. The Competition Tribunal was also clear on this aspect in *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy*[540] when it stated that an interpretation of the provisions of the Competition Act which elevates the tribunal to a super regulator with powers to remedy the actions of other regulators cannot be accepted.[541] It further stated that:

[536] Section 1 (A) (a) and (b) of the Competition Act 89 of 1998.
[537] Section 21 (i) of the Competition Act 89 of 1998.
[538] Section 21 (j) of the Competition Act 89 of 1998.
[539] Section 43E(1) (b) of the Competition Amendment Bill of 2018.
[540] [2009] 2 CPLR 379 (CT).
[541] *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy.*

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> "No such interpretation is authorised by the Act and indeed the fact that a regime is created for regulatory agreements between the Commission and other agencies to manage concurrent jurisdiction over competition matters, suggests that regulators are equal to and not subordinate to one another unless specifically provided for otherwise."[542]

Lastly, an active role by the Competition Commission as proposed in this study would not undermine the state's sovereignty in the form of its power to grant state aid to SOEs in the public interest, since the Commission's inquiry powers will be limited in several respects:

- They will not apply to state funding of all public entities but only those that carry on commercial activities;
- They will only be triggered where state aid in the narrow sense described above is given;
- The Commission will have limited powers to force the government to take steps to prevent harm.[543]

In conclusion, it is noted that the right of the state to provide state aid to SOEs and a potential role for the Competition Commission to evaluate certain state aids are not incompatible if an effective process is put in place**.** Also, since the proposed inquiry powers ensures the input of the body responsible for free and fair competition, competitors of the SOEs will be reassured that their interest are also being protected in the course of state aid proceedings.

3 3 2 Consequences if support is state aid and notification of state aid

It is proposed that the government should follow a European-style notification process when state aid as described above is to be given. The notification may be given either by National Treasury or by the Department under whose control the SOE that will receive the state aid falls.

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[542] *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy* [2009] 2 CPLR 379 (CT) 385.

[543] See the discussion in para 3.3. 2 where the role of the Competition Commission is explained and this matter is addressed.

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It is proposed that a final decision to grant state aid should not be made until the Competition Commission has concluded its evaluation of the state aid or the time for evaluation of the state aid has elapsed. In this respect the state aid regime could borrow from the rules regarding the notification of mergers. Section 14(2) of the Competition Act provides that an intermediate merger will be deemed to be approved if the Commission does not make a decision on the merger within the time or extended time set out in the section. The period within which state aid should be evaluated by the Commission should be carefully considered. It should be long enough to allow the Commission to do a proper analysis, but short enough to prevent unnecessary delays.

Unlike competition merger cases, it is not adequate that the final decision to grant state aid should merely be suspended until the Commission has completed its proceedings. It will become apparent from the description of the proposed process that it is necessary that the government should consider the final recommendations of the Commission regarding particular state aid. It is therefore necessary that the final decision to grant such state aid should not be given prematurely. The limited nature of the proposals bolster the conclusion that a final decision to give state aid should be possible only after the matter has been considered by the Commission. Only in those cases can the more limited powers of the Commission to consider state aid be influential.

3 3 2 1 Consequences of failure to notify

There might be circumstances when the government neglects to give the proposed notification to the Competition Commission of its intention to grant state aid as defined. Since the EU state aid rules are the yardstick for this study, this is the first place to search for an answer on what to do should the government neglect its proposed notification obligation. In this respect the proposal follows the EU where failure to notify the EU Commission causes the aid to be automatically illegal.[544] It may be argued that a domestic approach is needed due to the limited nature of the

[544] See the detailed discussion on this aspect in para 6 of chapter 4.

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proposals: that notification should not affect the legality of state aid. However, it is proposed that the more limited proposals rather bolster the conclusion that a final decision to give state aid should be possible only after it has been considered. This will ensure that the more limited powers of the Commission to consider state aid will be influential. However, it is accepted that the government might regard full illegality as going too far and being disruptive. Hence a compromise view is taken here. State aid that is given without notification will not be illegal. However, it will still be subject to evaluation through late notification or investigation on the initiative of the Commission. The Commission would then have the power to propose recovery of state aid that was implemented without notification. Again the grantor of the state aid would have to show this proposal was properly considered. If not certain legal consequences would ensue.[545]

Furthermore, the levying of a fine on the government for not notifying state aid would not be sensible for two reasons. First, a balance needs to be maintained between protecting of the competitive process and public interest considerations. Government should not be punished for executing its constitutional obligations to South Africans through the use of SOEs. Secondly, fines are paid into the National Revenue Fund. Where a fine is imposed on government it would just pay the fine to itself. At most it should be considered whether officials should be held liable for disregarding the requirements of the state aid regime and whether the state should be held liable in damages for harm caused by a failure to notify. These are questions which will not be taken further in this study.

It is further proposed that members of the South African public together with competitors of SOEs should be able to approach the Competition Commission to scrutinise the impact of state aid as defined if it was not notified.
- This right to complain could be akin to the right which members of the public have to ask the Public Protector[546] to investigate government actions. National legislation[547] in South Africa allows members of the general public to report any matter over which the Public Protector has jurisdiction to its office. The Public

[545] See the comprehensive discussion on this aspect in para 6 of chapter 4.
[546] The Public Protector was constituted in the Constitution of the Republic of South Africa.
[547] The Public Protector Act and the Constitution of the Republic of South Africa of 1996.

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Protector is competent to investigate any conduct in state affairs, or in the public administration in any sphere of government, that is alleged or suspected to be improper or to result in any impropriety or prejudice.[548] The purpose of the office of the Public Protector in South Africa is aptly summarised by the court in *South African Broadcasting Corporation SOC Ltd v Democratic Alliance*[549] where it states that in "modern democratic constitutional states, in order to ensure governmental accountability, it has become necessary for the guards to require a guard." In South Africa the Public Protector is that guard. All findings by the Public Protector are therefore binding until set aside by a court of law.[550] It is not proposed that the Commission should be given comparable powers to that of the Public Protector with regard to state aid matters. However, as with the Public Protector members of the public should be able to approach the Commission to scrutinise any of the forms of state funding described above.

- Some assistance can also be garnered from the rules in competition law that concern the submission of complaints concerning prohibited practices.[551] However, the submission of complaints will also in some respects differ from requests to scrutinise state aid that has not been notified. The Competition Commission will not be required to investigate once a request has been made. It will rather have a discretion to decide whether it should do so. Furthermore, binding decisions regarding prohibited practices that are subject to complaints will be made by the Tribunal. Decisions regarding state aid will be made by the Commission and not the Tribunal and will not be binding.

The proposed complaint procedure will in essence serve three purposes:

(i) it will alert the Commission to aid that was not notified if the Commission is not already aware of it;

(ii) it will be a counter measure to the government's failure to comply with the proposed notification process, since competitors will certainly be aware of the aid even if other members of the public are still unaware of it. The existence of a

[548] Section 182 of the Constitution of the Republic of South Africa of 1996.
[549] 2016 (2) SA 522 (SCA) 528
[550] See *Economic Freedom Fighters v Speaker of the National Assembly* 2016 (3) SA 580 (CC) para 56 and paras 72-75; *South African Broadcasting Corporation SOC Ltd v Democratic Alliance* 2016 (2) SA 522 (SCA) paras 52-54.
[551] Section 49B(2)(b).

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complaint procedure is likely to motivate government to comply with its notification requirement to avoid losing in the initiative in state aid proceedings; and
(iv) it may require the government to reconsider and retake decisions regarding state aid once recommendations have been made by the Competition Commission.

3 3 2 2 The problem of emergency funding of SOEs

As previously mentioned, the National Treasury used section 16 of the PFMA to transfer funds to recapitalise SAA.[552] Section 16 of the PFMA allows the Minister of Finance to authorise the use of funds from the National Revenue Fund in emergency situations. It may be argued that emergency funding has to be excluded from the operation of the suspension and perhaps also from the notification regime proposed here or perhaps even that emergency funding should fall completely outside the state aid regime. If the National Treasury did not use the "emergency section" of the PFMA for the granting of the funds, the creditors of SAA would have called up the guarantees provided in favour of SAA. The government thus had a choice between having the creditors call up the guarantee and recapitalising the airline. Both would have been significant events for competition between SAA and its competitors. Delays to allow for an investigation of state aid in these types of situations could be problematic.

Conversely, the fact that the government had to use the "emergency section" of the PFMA in recapitalising SAA is indeed worrisome, because one would have expected that the maturing of the liabilities to Standard Chartered Bank and Citibank would have been made part of SAA's projections in their budgets for that particular financial year, which would have provided the government with a clear picture of the airline's financial circumstances.[553]

It is therefore proposed that state aid to an SOE cannot be excluded from scrutiny merely on the basis that the government has decided to grant it as emergency funding. Emergency funding should not automatically be exempted from the

[552] See the discussion in para 3.2.3.3 of this chapter.
[553] See the discussion in para 3.2.3.3 of this chapter.

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application of the proposed state aid rules and a subsequent investigation by the Commission on the effect of the aid on the competitive process. Such a position might entrench even further the uneven playing field between SOEs and their competitors. If emergency funding was to be exempted from the proposed state aid rules, it could give carte blanche to SOEs not to do apt budgeting for a particular financial year as they would know that any funding emergency in the SOEs was certainly to be funded by the National Treasury under the "emergency section" of the PFMA. This is not a position intended by the study. Hence, it is recommended that the Competition Commission should be allowed to do a basic assessment regarding the impact of emergency state funding on the competitive process.[554]

At most the proposed new state aid regime should allow for:
- the fast-tracking of the consideration of notified state aid where necessity requires it; or
- even a Competition Commission power to authorise implementation before completion of the consideration of state aid.

Section 16 of the PFMA allows for emergency funding to be granted where it could not be postponed to a future budget without causing serious prejudice to the public. Perhaps "serious prejudice to the public" if a decision is delayed, should also be the test in the context of the application of special rules in the context of the state aid provisions.

3 3 3 Evaluation of state aid by the Competition Commission

Since this study uses the EU state aid regime as a benchmark, this is the first place to look for guidance on what the powers of the Competition Commission should look like in regard to state aid matters and when such powers should be exercised. As discussed in chapter four, the EU Commission has the power to decide on the compatibility of all state aid with the internal market. It exercises that power after it receives notification from member states of their intention to grant state aid or to alter

[554] See para 3.3.3.1 of this chapter for the factors which the Competition Commission should consider when it does such a basic assessment.

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existing aid. State aid that is given without notification is illegal. Cremona[555] further points out that a national monitoring authority of a country related to the EU ought to have powers similar to those of the EU Commission in order to successfully enforce state aid rules.[556]

As to what the Competition Commission's powers should look like and when the Commission should exercise such powers, a number of factors should be borne in mind.

- State aid to SOEs will remain pervasive in South African to allow them to achieve their public mandates.
- The allocation of state aid in South Africa will for the most part remain a political decision. The focal point of these decisions will continue to be the mandates of SOEs and the delivery on their mandates. It is proposed that there should only be limited consideration of the impact of the state aid on the competitive process.
- It is accepted that the Competition Commission will not find it easy to determine whether aid, will be used by the SOE for its commercial activities or its governmental mandate or both, even if at first sight it might seem that the aid will be used for commercial activities.
- Finally, it may be difficult to establish whether state aid will, on the whole, have a negative effect on competition, even if it is clear that it is intended to support business activities.

As is argued throughout, the European state aid regime would therefore in several respects be inappropriate for the South African context. It would be too ambitious to propose the conferral of a general power to determine whether state aid should be allowed on South Africa's Competition Commission, as is done in the EU. Realistically, the South African government will not agree to submit itself to such a power, where it wants to grant state aid. In a developing country such as South Africa, it is at least arguable that there are good reasons for such refusal.

[555] M Cremona "State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements (2003) 9(3) *European Law Journal* 268.
[556] See the discussion in par 22 of chapter 5.

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Nonetheless, this study shows that there cannot be total acceptance of all types of state aid, granted under all circumstances and at any time, regardless of the reasons for and negative impact on competition they may have. It is proposed that there are clearly circumstances where state aid should be scrutinised to determine whether it is likely that it will distort competition without sufficiently benefitting the public interest. Hence, this study strives to find a compromise position, which simultaneously is mindful that government will always grant state aid to SOEs in order for them to achieve their mandates but also protects the competitive process to some degree.

It is therefore proposed that in the instances where state aid in the manner described above has been given, the Competition Commission should be able to determine whether the state aid is likely to have a distortive effect on competition. It should have the power to make non-binding recommendations that would limit or prevent the distortive effects of the state aid. The inquiry powers of the Commission in terms of the state aid provisions should not only apply to those SOEs which have private competitors, but to all those SOEs which are operated in accordance with business principles. The Competition Commission should also be given a broader mandate to make proposals on how competition can be expanded to promote efficiency of SOEs even in those industries where they currently operate as monopolists. SOEs such as SAA and the SABC, but also entities such as Eskom and PRASA, which are some of the worst offenders when it comes to state aid, will therefore be subject to scrutiny.

3 3 3 1 How an evaluation should be done

It is not suggested that the Competition Commission should undertake an in-depth and time consuming inquiry. Any prolonged inquiry would impact on the already limited time and resources which the Commission has to investigate hard-core anticompetitive behaviour, such as cartels. It is recommended, though, that the Competition Commission should make an assessment based on a basic economic analysis of what the impact would be. For purposes of such a basic economic analysis the Competition Commission could consider some general information which is readily available within the market in which the SOE is operating, although it

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is of course the Commission's prerogative to go beyond these readily available factors.

When the Competition Commission does an inquiry, it should determine whether the state aid to the SOE has the potential to distort competition in the market. Such a determination can be made by taking into account the following basic factors:
(i) the number of competitors operating within the market;
(ii) whether there has been any recent entrants into that specific market;
(iii) whether there are any competitors that went out of business in that market in the recent past and if affirmative, whether there are any allegations that such failure had anything to do with the operations of the SOE;[557]
(iv) whether the SOE has been subjected to investigation by the Commission for any anticompetitive behaviour;[558]
(v) whether the state aid to the SOE would make any significant contribution to the general economy or rather impact negatively by affecting the business operations of well-functioning competitors in the market;
(vi) whether the SOE has been given state aid in the past;
(vii) any operational losses indicated in the SOE's financial statements of the previous year;[559]
(viii) any irregular expenditure and fruitless and wasteful expenditure stated in the SOE's financial statements;[560] and
(ix) whether there were in the past or still are governance and management problems within the SOE.[561]

Furthermore, the Commission could look beyond these factors to other aspects which it considers important to make such a determination. If the conclusion is that the state aid will have no or a negligible impact on competition, it should mark the end of the inquiry.

[557] See the discussion in para 1.1(c) where reference is made to two of SAA's former competitors, Nationwide and 1Time, both of which are not operating business anymore.
[558] See the discussion in para 1.1(a) on SAA's past anticompetitive behaviour when it entered into various incentive scheme agreements with travel agents between 1999 and 2005 to sell its domestic tickets instead of those of its competitors in exchange for a commission .
[559] See the discussion in para 3.2.4.2 of this chapter on operational losses.
[560] See the discussion in para 3.2.4.1 of this chapter on irregular, fruitless and wasteful expenditure and fraud
[561] See the examples from the case law of governance failures in SOEs in para 1.2(b).

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However, if the conclusion is that the negative impact on competition would be material, the public interest benefits that will derive from the state aid, must be considered. Because of the mandates of SOEs in South Africa[562] and the rationales[563] for having them as active participants of the South African economy, there will always be public interest considerations involved when state funding is granted to them. This requires that the Commission must take such public interest considerations into account during its determination of the potential harm.

This in essence requires that the granter of the state funding should be given the opportunity to demonstrate the harm to public interest considerations if the state funding is not granted. The Commission will have to balance the competition and public interest consequences of the state aid.[564] The recommendations made by the Competition Commission on how to minimise the harm to the competitive process by the state aid should therefore take into account any submissions on public interest considerations made by the granter of the state aid. A balanced inquiry by the Commission will ensure (i) that competition does not take preference over public interest considerations in a country where inequality and poverty are at high levels and (ii) that the recommendations made by the Commission are cognizant of those public interest considerations.

It was proposed above[565] that SOEs which have public service obligations will be included in the scope of the proposed state aid legislation, albeit subject to a clear possibility for state aid to these SOEs to be approved or more generally absolved from the application of the proposed rules, much like the position of providers of SGEI. It is proposed that this should be done by applying the public interest test as referred to here.

[562] See the comprehensive discussion on SOEs in South Africa in para 3 of chapter 2.
[563] See the comprehensive discussion on SOEs in South Africa in para 3 of chapter 2.
[564] See *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 56 discussed below in para 3.3.3.3.
[565] Chapter 5 para 3.1.

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The type of considerations that will have to be taken into account in determining whether state aid can be justified in the public interest will be broadly similar to those that apply to determine whether aid should be allowed in terms of the *Altmark* criteria and the "SGEI package"[566] or some of the the exemptions in the GBER. However, the proposal currently is not that aid should be ex ante exempted on a similar basis. In essence, there first needs to be a general framework on the regulation of state aid to SOEs established by the Commission and only then can further attention be given to exemptions and leniency in regard to SOEs which have public service obligations such as Eskom, PRASA, SABC and SAPO. There are currently few constraints on state aid to these entities and a culture of restraint with regard to the granting of aid still has to be established. Moreover, other aspects of the proposal will still ensure that the state will broadly be able to provide aid in the public interest: 1) Commission decisions regarding state aid will not be binding, and 2) it is proposed that aid that is given by state departments in terms of their normal budgetary process will not be regarded as regulated state aid.

3 3 3 2 Steps that the Commission must take after the inquiry

Every Competition Commission inquiry into state aid must conclude with the preparation and submission of a report. This report must be submitted to the relevant authority having oversight of the SOE which will receive the aid and to the National Treasury. If the Competition Commission concludes that there will not be a material impact on competition, its report should give reasons for this conclusion. If the Competition Commission concludes that state aid will be substantially anti-competitive the report should state:

- to what degree the state aid is likely to impact on competition within the market in which the SOE operates;
- to what extent public interest in the granting of the state aid would outweigh the harm to competition;
- whether the state aid should proceed at all in light of the competitive and public interest effects;

[566] See the discussion on SGEI in the EU in para 7.2 of chapter 4.

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- if the anti-competitive consequences of the state aid can be ameliorated by means of special measures such as the imposition of conditions.

In determining the last aspect, conditions for state aid proposed by the granter should be taken into account. In the recapitalisation of SAA, Parliament's Standing Committee on Appropriations recommended in the Budget Review 2018 that the Minister of Finance should strengthen the conditions attached to the recapitalisation of SOEs such as SAA to minimise the risk to the state. The Committee[567] recommended that government should consider making conditions such as the following part of future recapitalisations of SOEs:

(i) no-bailout clauses;

(ii) stricter monitoring of the SOEs' contingent liabilities;

(iii) that the Minister of Finance publish potential circumstances present in SOEs which could negate the granting of government guarantees; and

(iv) personal liability of boards and executives of the SOEs for failure to properly managed the funds of SOEs.

If such conditions are imposed it should be considered whether they are adequate and even whether they would not further undermine the impact of state aid. Even with such conditions in place SAA will remain technically insolvent for some time into the future. This may mean that further state aid will have to be given and SAA will continue to be a drag on the South African economy.

As previously mentioned, it is not proposed that the inquiry powers of the Commission should entitle the Commission to force the government to protect the competitive process, because other interests will often take priority. Proposals in the report of the Commission will only constitute recommendations.

3 3 3 3 Response of the Government to a report

Government will not be bound by recommendations of the Competition Commission on state aid. In *Comair Limited v Minister of Public Enterprises*[568] the court correctly stated that "members of the executive have a wide discretion in selecting means to

[567] Budget Review 2018 111-112.
(accessible at http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf).
[568] 2016 (1) SA 1 (GP) para 56.

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achieve constitutionally permitted objectives" Considering the crucial mandates of SOEs and how these entities are supposed to allow the government to comply with its constitutional responsibilities, any proposed regulatory measures to prohibit state aid or impose binding conditions, in order to protect the competitive process are unlikely to receive political support.

However, outside perhaps of some forms of emergency aid, and cases where state has been implemented without notification,[569] the final decision to grant state aid may be made only once the Competition Commission has reported on it. The granter of state aid would therefore have to apply its mind to the Competition Commission report but may ultimately reject its findings and recommendations. Procedures should therefore be provided to ensure that recommendations of the Commission are taken seriously and consequences must ensue if this is not done.[570]

The recommendations of the Commission will, hopefully guide the government to act in ways which will limit any potential distortion of competition when it grants the state aid. If the South African government is serious about pursuing the aims in the National Development Plan: an economy that is efficient, shows steady and inclusive growth, is fair and works for every South African, it will give serious consideration to the findings of the Commission on the impact of any state aid.

As the Commission's recommendation will serve as guidance only, there is no need to grant the Competition Tribunal any power to review Commission decisions regarding state aid. This position is of course different in the EU where any decision on state aid by the EU Commission is binding on the member state concerned and both the Commission and the relevant member state can approach the CJEU after a decision on state aid has been made: the EU Commission can do so if the member state does not comply with its decision or the member state can do so if it feels that the EU Commission made a wrong decision in regard to the state aid.

[569] Above 3.3.2.1.
[570] See chapter 6 which takes this issue further.

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The proposed state aid powers of the Competition Commission and its impact on the decisions of government to grant state aid accordingly can be explained with reference to the most typical and arguable the most dangerous form of state aid that is granted in South Africa. When the government decides to issue a guarantee to an SOE which allows the SOEs to borrow from lenders, the Competition Commission will be able to look into the effect on the competitive process. In *Comair Limited v Minister of Public Enterprises,* Comair argued that they were not given an opportunity to make representations to the government prior to the taking of the guarantee decision even though the guarantee "would have a prejudicial effect on Comair and the domestic air transport industry." Furthermore, Comair contended that the granting of the guarantee in that way was in breach of Comair's legitimate expectations. Comair, amongst other relief sought, wanted the court to review and set aside the guarantee. Comair is the first privately-owned competitor but will certainly not be the last to put forward the contention that the granting of a governmental guarantee harms competition, after it has been given to a rival SOE. For as long as competitors of SOEs feel that governmental guarantees impinge on the competitive process, the likelihood of seeing similar future cases before the courts is high. One way to hear the competitors of SOEs in regard to governmental guarantees, is to give the Competition Commission, which is the body responsible to ensure free and fair competition, the power to report and make recommendations on state aid and to force government at least to pay attention to these reports and recommendations. The state aid provisions do not grant a right to make representations directly to the authority that decides whether state aid should be granted but it will mean that the Commission will receive such representations, will have to make recommendations to the authority and the authority will have to apply its mind to the recommendations.

3 3 4 Market Inquiry powers can supplement the state aid regime

It should also be borne in mind that mechanisms outside of state aid rules may be used to supplement the proposed state aid regime. In particular, the newly revamped provisions on market inquiries allow the Competition Commission to do market

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inquiries into the impact of state aid on the general state of competition in those markets in which SOEs operate.[571] A market inquiry is defined as "a formal inquiry in respect of the general state of competition, the levels of concentration in and structure of a market for particular goods or services, without necessarily referring to the conduct or activities of any particular named firm".[572] Of importance for this study is that the Commission will be allowed to do market inquiries into the structure of a market, which may include any past or current advantage of a firm that is not due the firm's own commercial efforts or investments but due to state support. It is clear that the powers which the Competition Commission will have in regard to market inquiries, are wide enough to encompass an inquiry into the effect of state funding of SOEs which are firms and those that are operated in according to normal business principles.

The Commission will thus be able to initiate and conduct a market inquiry as set out in section 43B of the Competition Act. This section, inter alia, requires the Commission to publish a notice in the government Gazette twenty days before the commencement of an inquiry which sets out the terms of reference of the inquiry and invites members of the public to provide information to the inquiry. Members of the public and the competitors of SOEs would therefore be able to make submissions to the Commission.

Section 43C requires the Commission to publish a report of the inquiry in the government Gazette and submit it to the Minister of Trade and Industry with or without recommendations.[573] The Commission has a duty to remedy adverse effects on competition if it is found in the inquiry that there is indeed an adverse effect on competition.[574] In terms of the new provisions an adverse effect on competition is established if "any feature, or combination of features, of a market for goods or services impedes, restricts or distorts competition in that market."[575] The Commission will then be able to make non-binding recommendations to a Minister or

[571] These provisions were enacted in the Competition Amendment Act 18 of 2018. They have not yet come into effect.
[572] Section 43A(1).
[573] Section 43E.
[574] Section 43C(3).
[575] Section 43A.

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binding recommendations to any person who apparently may include any government officials or Ministers to address the adverse effect on competition.[576] The only limitation will be that "[a]ny action in terms of subsection (1) must be reasonable and practicable, taking into account" certain relevant factors listed in the Act.[577] These provisions will allow the Commission to take firmer action than in terms of the proposed state aid regime, if that is required.

4 Concluding Remarks

South Africa currently finds itself in a precarious position. Not only does it have to remain economically stable, but it also has to eradicate the inequality and poverty caused by decades of racial discrimination laws. As a result, several markets within its relatively "small economy" are dominated by large SOEs which conduct commercial activities but also have to meet "developmental and national needs". It is therefore understandable that the South African government wants to hold on to and continue to support SOEs which will assist it in reaching its developmental goals. There is thus no doubt that these entities will be around for as long as they are needed to assist with the enormous socio-economic challenges faced by South Africans. This became clear when President Cyril Ramaphosa stated in his first State of the Nation Address that "[we] will intervene decisively to stabilise and revitalise state owned enterprises."[578]

However, any view by the government that the granting of state aid to SOEs under all circumstances, regardless of the failures and worrisome conditions[579] within the SOEs, will ensure that the government reaches its developmental goals and create an economy which will benefit all South Africans, is not convincing. The South African government's persistent financial assistance to SOEs threatens not only free and fair competition, but the economy as a whole. It is not disputed that the demise of an SOE would lead to major economic disruption for South Africa, but is it always enough to justify perpetual state aid to SOEs by saying that their failure would be

[576] Section 43C(3) read with 43D and 43E(1).
[577] Section 43D(4).
[578] State of the Nation Address 2018 (accessible at http://www.thepresidency.gov.za/state-of-the-nation-address/state-nation-address-president-republic-south-africa%2C-mr-cyril-ramaphosa).
[579] See the discussion in para 1. 2 of this chapter on poor governance and financial mismanagement in SOEs.

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"disastrous"?[580] At present it seems as if the South African government tends to concentrate more on providing SOEs with state aid than on implementing strategies which will allow SOEs to become viable entities. Such an approach cannot work in the long term and is not beneficial to the economy or South Africans. Hence, the public interest goals of SOEs should not necessarily exclude South Africa from having rules in place to supervise state funding of SOEs. If the government continues to provide state aid to SOEs, regardless of the circumstances, it should seriously consider the proposed position in this chapter which sets out clear delineated boundaries for state funding. The regulation of state aid to SOEs could thus be the way forward as it would not only protect the competitive process, which in itself will be good for the economy, but it may also improve financial management and governance within these entities and contribute to the promotion of the public interest mandates of these SOEs.

President Ramaphosa undertook in his first inaugural State of the Nation Address in February 2018[581] to review the funding model of SOEs after an extensive process of consultation with all stakeholders. The President provided no specific details as to how the funding of SOEs might change. Consequently, it remains to be seen how the funding model of SOEs, which at the moment is clearly creating significant pressure on the public purse, will be addressed.

It will not be easy to convince policy makers that the discretion of the government to give state aid to SOEs should be constrained as proposed in this chapter. It is, however, clear from the whole analysis in this chapter that there is a need in South Africa to address the harm that is caused to the competitive process (and by extension the economy) by state aid to SOEs. It is also apparent that there are regulatory models that can accommodate the need for supervision of state aid without restricting the ability to utilise SOEs to achieve developmental mandates.

END OF CHAPTER

[580] See *Comair Limited v Minister of Public Enterprises* 2016 (1) SA 1 (GP) para 40 where the court stated that SAA's "disorderly failure would probably impact drastically on the South African economy" and also the assessment by the National Treasury that SAA's "disorderly demise would be disastrous".
[581] The 2018 State of the Nation Address can be accessed on: (http://www.thepresidency.gov.za/speeches/state-nation-address-president-republic-south-africa%2C-mr-cyril-ramaphosa).

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CHAPTER 6: CONCLUSION

1 Conclusion

The decision to embark on this study was prompted by the unlimited state funding to SOEs, even while these enterprises are governed and managed in ways which are below the minimum standard of good governance and management required by different legislation. The goals of this study as stated in chapter one is to propose a legal framework that would contribute substantially to, first achieving proper regulation of state funding to SOEs and secondly, creating a level playing field between SOEs and their competitors. This study has shown that these goals can be promoted if (i) certain forms of state aid granted to SOEs are notified and assessed by the South African competition authorities and (ii) that the realization of state aid regulation for South Africa is within reach if careful consideration is given to the domestic reasons and circumstances for state aid to SOEs. In light of the findings in chapter 5 a number of important concluding remarks are made.

First, with SOEs being such prominent role players in the South African economy, the government does not have to be concerned that the proposed position in this study will negatively impact on their continuous importance and existence to help shape South Africa to the benefit of all South Africans. The positive contribution by many SOEs is clearly visible in South Africa and this contribution has been acknowledged throughout the study. SOEs are major employers, they develop infrastructure and supply affordable products and services such as electricity, clean water and sanitation services to many poor South Africans who would not be able to acquire them through normal market mechanisms. This study therefore recognises throughout, the need for SOEs to be part of the South African economy to help the government on these fronts. Furthermore, chapter two of this study has shown that it is not unique to South Africa to have SOEs, which are financed by the state, as significant economic players. Previously, SOEs were crucial to the economies of many developed countries: they were used as tools for economic development after a major economic downturn following harmful historical events such as wars.[1] In the USA state ownership of certain industries was a key tool of the reconstruction

[1] See chapter two for a detailed discussion on state-ownership of key industries in Britain, Germany and France and chapter three for a discussion on state ownership in the US.

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programmes to bring that economy out of the Great Depression, while in Europe the devastation caused by the two World Wars saw countries use state-ownership to rebuild their economies.[2] The governments of countries such as Britain and France were big proponents of state ownership of key industries after World War II.[3] In Britain, the country which was once the governing power in most of Africa, including South Africa, many industries were taken into government ownership in the 1950s.[4] The British government took ownership of industries such as coal, railways, road transport, electricity, airlines, telecommunications and iron and steel.[5] State ownership of key industries in France after World War II was so significant that its nationalisation plan was described as "the broadest set of nationalization projects ever undertaken at one stroke in a free market economy."[6] In recent times though, state ownership of enterprises in developed countries has become the exception rather than the norm. Britain, in particular, saw major privatization in the 1980s and state ownership only returned to a limited extent during the dark days of the 2008 financial crisis.[7] Like South Africa today, developed countries then also considered state ownership as a problem-solving tool. SOEs will therefore remain part of the South African government's problem-solving tools but it is envisaged that the proposed position in this study will strengthened the regulatory framework regarding their funding not only for the benefit of the competitive process but the economy as a whole

Second, this study has shown that some level of state aid to South Africa's SOEs which have private competitors need to be allowed because these enterprises have

[2] See E Voszka "Nationalization or Privatization? The Fragmentation of the Mainstream" (2017) 88(1) *Annals of Public and Cooperative Economics* 91 93.
[3] See chapter two for a detailed discussion on state ownership of key industries in Britain, Germany and France. See also WA Robson "Nationalised Industries in Britain and France" (1950) 44(2) *The American Political Science Review* 299 299-322.
[4] R Milward "Industrial organisation and economic factors in nationalisation" in R Milward & J Singleton (eds) *The Political Economy of Nationalisation in Britain, 1920-1950* (2002) 3 3.
[5] R Milward "Industrial organisation and economic factors in nationalisation" in R Milward & J Singleton (eds) *The Political Economy of Nationalisation in Britain, 1920-1950* (2002) 3 3.
[6] J-F Revel "The quiet revolution" (1981) 3 *McKinsey Quarterly* 48 50.
[7] In the United States, Britain and Germany the governments provided rescue measures to some of its major financial institutions to save them from failure. As a consequence some of these institutions were nationalised such as the Royal Bank of Scotland in Britain. See A Brummer "Where the credit crash came from" 2008 *Management Today* 34 34-37 for an analysis on the development of the 2008 financial credit crisis and how central governments decided to provide rescue measurers during this time.

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crucial governmental mandates. It is therefore accepted that SOEs which have a general public interest role should, to some extent, be able to rely on the financial backing of the state. If these enterprises do not receive state aid, they might be at a competitive disadvantaged because they, unlike their private competitors, also have to incur the cost of achieving their governmental mandate. Hence, competition concerns should not be decisive when state aid is granted via the budgetary processes to help SOEs to achieve their mandates.

Third, even while it is acknowledged that some level of state aid need to be allowed to SOEs which have private competitors, this study has shown that South African policy makers can no longer ignore that state aid may significantly undermine free and fair competition.[8] This became particularly clear in one industry in which the South African government operates at least two SOEs. As indicated in chapter 5, in the airline industry, in which the government operates SAA and SA Express, some privately owned competitors failed in the past and in one case[9] the state supported beleaguered national airline was held responsible for the failure. This has shown that it is not unreasonable to expect that every role player, state-owned and privately owned, should be expected to play its part to reach the goals of free and fair competition.

Fourth, although competition law, as Fox correctly states, was meant to regulate the behaviour of private enterprises only,[10] this study has shown that there is room in South Africa to regulate state aid to SOEs as part of competition law. This is especially true in light of both the findings in chapter 5 and the recent words of the Commissioner of the Competition Commission, Thembinkosi Bonakele: "There should be a clear competition policy on state-owned enterprises which addresses,

[8] See the *Nationwide Airlines (Pty) Ltd (In Liquidation) and South African Airways (Pty)* [2016] 4 All SA 153 (GJ).
[9] See the *Nationwide Airlines (Pty) Ltd (In Liquidation) and South African Airways (Pty)* [2016] 4 All SA 153 (GJ).
[10] EM Fox & D Healey "When the State harms Competition- the Role for Competition Law" 2013 79(3) *Antitrust Law Journal* 769 769.

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among other things, transparency in pricing, cross-subsidisation and bailouts."[11] There can be no doubt that state aid in certain circumstances is a "state-initiated restraint" on competition which may weigh heavily on competition. It shields poorly governed and mismanaged SOEs against bankruptcy, disadvantages more efficient competitors of SOEs which could contribute significantly to the economy and prevents new potentially efficient competitors from entering markets in which SOEs operate. In this way it undermines the objectives of competition legislation. Hence this study is in full agreement with Lowe and Held where the authors state: "Whilst governments and the public sector have a crucial and legitimate role to play in many spheres of economic activity, competitive markets ensure that the desired range and quantity of goods and services which respond best to consumers' needs are produced at the lowest possible cost to society".[12] Currently South Africa's competition legislation has broadly the same scope as most other competition laws outside of Europe. It does not deal directly with state aid to SOEs. However, an extension of the Competition Act under influence of EU state aid rules is proposed in order to address the anti-competitive effects of state aid that is not properly constrained by the law.

Fifth, this study has shown that continuous uncontrolled state aid could potentially prevent SOEs from being or becoming responsible and efficient market players as they know that they can constantly rely on the financial muscle of the state. State aid may also contribute to poor governance and financial mismanagement, which the study has shown clearly is a huge problem in the majority of SOEs. Poor governance and financial management creates a vicious cycle which culminates in financial support to SOEs. Chapter 5 has shown that the most harmful types of state aid in South Africa are guarantees and recapitalizations. These types of state aid are often used to keep SOEs afloat. They are particularly problematic as they do not only harm competition but may also lead to a failure in proper governance as those in charge know that these enterprises will always have the financial backing of the

[11] https://www.fin24.com/Economy/competition-policy-on-soes-must-be-clear-commissioner-20170831 (accessed on 2 April 2019).
[12] P Lowe & A Held "Modernisation and Beyond: The Role of Competition Policy in Driving Economic Growth" (2005) 1(1) *European Competition Journal* 35 36.

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state. They represent wasting of government resources as they cannot be clearly tied to the governmental mandates of these enterprises. Furthermore, they weigh heavily on the fiscus as they frequently involve large sums that are committed outside of the ordinary budgeting processes.[13] It is envisaged that state aid control rules in South Africa will lead to improved governance and financial management for both government and its SOEs. In this sense the aim is that state aid rules will help SOEs to become more efficient and their management more responsible in their behaviour.

Sixth, this study has shown that even with all the financial support that they get, SOEs on many occasions still do not effectively deliver on their mandates. The biggest culprits regularly receive state aid such as Eskom and SAPO. Post-Apartheid Eskom is supposed to supply and distribute fairly priced electricity to power the economy and make the lives of all South Africans more comfortable. Nevertheless, the "loadshedding" crisis in recent years has shown the lack of sufficient long-term planning by Eskom. SAPO's mandate is to provide postal services efficiently to all South Africans but because of reliability problems, those who can afford it, prefer to use the services of private providers such as DHL. South Africans who cannot afford the services of private postal service providers simply have to endure the services delivered by SAPO.[14] Furthermore, the government envisages SAA to be the flagship national carrier for South Africa that should connect Africa to South Africa and the world. Nevertheless, over the years SAA has become such a burden on the fiscus,[15] that the government took the unprecedented step in December 2014 to transfer[16] the airline from the oversight of the Department

[13] See for example See column 9 of the Adjustment Appropriation Bill of 2018 on the "specific and exclusive" appropriation that was made to SA Express in 2018 and column 7 of the Adjustment Appropriation Bill of 2017 on the "specific and exclusive" appropriation that was made to SAA in 2017.

[14] See for example the recent report issued by the Office of the Public Protector on alleged maladministration and corruption within the South African Post Office. (http://www.pprotect.org/library/investigation_report/investigation_report.asp).

[15] Just recently is was reported in the South African media that SAA is actually in more financial trouble than reported. See the media article by M le Cordeur "SAA bleeding billions more than first reported" (http://www.fin24.com/Companies/Industrial/revealed-saa-bleeding-billions-more-than-first-reported-20170317).

[16] Such a transfer is made possible by section 97 of the Constitution of the Republic of South Africa of 1996 which deals with the transfer of functions by the President of South Africa from one cabinet member to another cabinet member. Section 97 provides that:

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of Public Enterprises to the National Treasury. These are clear indications that inefficient SOEs that are not subject to the discipline of competition when it comes to their market activities are at present not effective in promoting their governmental mandates. The cost of many SOEs does not justify the limited public interest benefits that derive from their activities. It is therefore suggested that properly formulated state aid rules could assist in ensuring that SOEs efficiently promote their governmental mandates.

Seventh, the discussion in chapter 5 has shown that it is those SOEs which are classified as "national government business enterprises" such as SAA and SA Express and those which are operated in accordance with normal business principles such as PRASA and SAPO, which are weighing down the economy. They receive persistent state aid because of various factors such as non-performance, operational losses, corruption and fraud and financial maladministration. Hence, state aid to these SOEs should come within the ambit of the proposed regulatory measures.

Eight, despite this study identifying serious problems within SOEs, including financial mismanagement, poor governance and high levels of corruption, it is recognised that privatisation is often not the best response. Like all other policy instruments, privatisation[17] has it successes and failures. Koch[18] states that the "knee-jerk reaction for paralysis in state-owned enterprises is to call for privatisation" since privatisation has often been seen as "a panacea for all economic ills" of SOEs. It is understandable that the first calls may always be for the privatisation of dysfunctional

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"The President by proclamation may transfer to a member of the Cabinet-
(a) the administration of any legislation entrusted to another member; or
(b) any power or function entrusted by legislation to another member."

[17] For more on privatisation of SOEs in South Africa see MS Binza "The Changing Balance between State and Market: A Case of the Privatisation Process of State-Owned Enterprises in South Africa" (2007) 42(7) *Journal of Public Administration* 721 721-732.

[18] S Koch "The secret to successful state-owned enterprises is how they are run" *The Conversation* (22 January 2016) (http://theconversation.com/thesecrettosuccessfulstateownedenterprisesishowtheyrerun53118).

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SOEs[19] but the following negative consequences may outweigh the benefits. First, privatisation is incompatible with the government mandates of SOEs. Privatisation may hamper the government's ambition to achieve an equal and just society for all South Africans. Secondly, SOEs are major employers in key industries in South Africa and privatisation may lead to retrenchment and further worsening of South Africa's horrific unemployment statistics.[20] Lastly, privatisation without any government regulation may not be optimal for consumers or the competitive process. An SOE which becomes a privately owned dominant enterprise is likely to abuse its dominance and increase prices. Makando[21] states that with privatisation comes deregulation and that privatisation without any "regulatory reform" may lead to just the opposite of public benefit as the absence of any regulatory reforms may lead to private monopolies of the privatised SOEs. In regard to ISCOR, for example, the Competition Tribunal noted that its privatisation led to a "privately owned and unregulated monopoly".[22] After privatisation, Sasol also remained a giant in the South African chemical sector and as recently as in 2014 (long after its privatisation by the Apartheid government) its dominance was still a challenge within that sector. In *Competition Commission of South Africa v Sasol Chemical Industries Limited*[23] an expert witness for the Competition Commission stated that the source of Sasol's market power was not innovation but the benefits it enjoyed while being an SOE. These South African privatisations have certainly not been successful in creating greater competition in most of the markets in which they operate. That privatisation is not the optimum solution for all the problems within SOEs is particularly important in regard to those SOEs which provide essential services and products to vulnerable South Africans. It may lead to price increases for services and products currently delivered by SOEs, which will put them further beyond the reach of those South Africans. Consequently this study comes to a conclusion that privatisation should not be considered as the ultimate and only viable option for non-performing and

[19] The Democratic Alliance (DA), the main opposition party in South Africa, is one of those parties which call for privatisation of certain SOEs such as SAA. The DA identifies SAA, Eskom, SANRAL, PETROSA, SAPO and PRASA as the "largest offenders" which costs the economy "billions"
(See https://www.da.org.za/2016/03/privatisation-the-only-solution-for-saa/).
[20] South Africa's current unemployment rate stands at 27,1%. See http://www.statssa.gov.za/.
[21] T Makondo "Privatisation as a major reform in public sector management" in K Moeti (ed) *Public Finance Fundamentals* (2007) 111 114.
[22] In this regard see the statement by the Competition Tribunal of South Africa in *Harmony Gold Mining Company Ltd and another v Mittal Steel South Africa Ltd and another* [2007] 1 CPLR 37 (CT) 73.
[23] [2014] 1 CPLR 155 (CT) 176.

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dysfunctional SOEs. It is rather proposed that more should be done to ensure that SOEs are governed and operated effectively and a state aid control regime may assist in this aim.

Ninth, the implementation of state aid control rules, which are guided by the EU state aid rules, can effectively supplement other policies and legislation in South Africa which is intended to encourage effective and efficient management of the finances of SOEs. In particular, state aid rules will support the PFMA, the Companies Act, SOE specific enabling legislation and other related legislative instruments. The PFMA[24] is a strong legislative instrument which attempts to regulate government spending of public money. However, the identification of financial mismanagement within a number of SOEs proves that some of them show scant regard for the PFMA. The many court cases on financial mismanagement within SOEs, which were discussed in chapter 5, and the various Public Protector[25] reports referred to in that chapter serve as illustration that the PFMA as a regulatory measure to ensure efficient and effective financial management of SOEs is not as effective as it should be considering the powerful provisions of the Act. Hence, a state aid regime could supplement the PFMA in the control of the finances of SOEs.

Tenth, it is proposed in Chapter 5 that the Competition Commission should be given the power to scrutinise and make recommendations regarding state aid to SOEs, in order to ameliorate the competitive impact of that state aid. This will increase the transparency around state aid decisions. This transparency and the proposed right of competitors to approach the Competition Commission to scrutinise the impact of state aid if not notified by the government, may allay some of the fears of competitors and potential competitors.[26] The involvement of the competition authorities in the evaluation of certain state aid to SOEs therefore may (i) encourage new entrants into markets and (ii) promote investment by existing competitors in

[24] See the discussion in para 3.3.1 chapter 5.
[25] See the reference to the many Public Protector Reports on financial irregularities, even criminal conduct and examples from the case law of governance failures of SOEs that are still receiving state aid in para 1.2 (a) and para 1.2.2 of chapter 5 respectively.
[26] See in this regard para 3.3.5 of chapter 5.

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markets where SOEs operate. Through the involvement of the competition authorities in the granting of certain state aid, the government would also give effect to the "constitutional promise of transparency" referred to by Justice Sutherland in *South African Airways SOC v BDFM Publishers (Pty) Ltd.*[27] It would be a historical day if the South African competition authorities become the first outside the EU to be consulted when state aid to SOEs, is considered. Not only will the competition authorities take charge of the fight against private restraints on competition but it will also become involved in governmental decisions which could possibly end up as public restraints on competition.

Eleventh, this study shows that the absence of supranational status as in the EU is an obstacle which can be overcome with a carefully drafted regulatory instrument which takes into account the rationales for the existence of SOEs in South Africa. The discussion in chapter 5 has shown that it might be difficult but not completely impossible to implement state aid rules within a single state such as South Africa. It is acknowledged that a single country such as South Africa does not need a state aid control regime for the same reasons than the EU.[28] The reasons for proposing a state aid control regime for South Africa are very different from those listed by the founders of what would later become the EU in the Spaak Report,[29] for implementing a strict state aid control regime. Nevertheless, the EU state aid rules can still serve as guidance generally on how to control state aid in South Africa.

In conclusion, it is submitted that the current position in regard to state aid to SOEs cannot continue perpetually. Action needs to be taken. As much as the admirable

[27] [2016] 1 All SA 860 (GJ) 882.
[28] The reasons for the existence of the state aid control regime in the EU are comprehensively discussed in chapter four of this study.
[29] The "Report of the Heads of Delegation to the Ministers of Foreign Affairs", also commonly referred to as "Spaak Report. The report is named after Paul- Henri Spaak, who was the chairman of the Spaak Committee, whose recommendations ultimately resulted in the signing of two of the founding treaties of the EU namely the treaty on the European Economic Community and the Treaty on the European Atomic Energy Community, which together with the European Coal and Steel Community forms the foundation of the EU as it is known today. For more on the Spaak Report see D Hildebrand *The Role of Economic Analysis in the EC Competition Rules* 3 ed (2009) 9; and JJP Lopez *The Concept of State Aid under EU Law: From internal market to competition and beyond* (2015) 36.

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roles of SOEs in South Africa have been acknowledge throughout this study, the reality is that certain state aid to commercialised SOEs and those operated in accordance with ordinary business principles, need to be scrutinised for the benefit of all South Africans and the economy as a whole and not only for the benefit of private competitors. At this stage in South Africa, it might be too ambitious to believe that the government would consider a legally binding state aid control regime. The South African government believes that SOEs are central to its attempts to develop the economy and alleviate poverty for the majority of South Africans. Moreover, Andreas Bartosch[30] is correct when he states that "not many governments may be interested in the establishment of an independent control body [or in this case control policy] telling them how to spend their budgets." Even so, the present situation in South Africa, which sees the financial mismanagement and poor governance of many SOEs, should be South Africa's catalyst to move from regular state financial intervention in regard to SOEs to exceptional state financial intervention. Not only will it provide protection to competitors of SOEs but it will also contribute to the broader economy because the government might be able to rely on the revenues of SOEs instead of SOEs relying on state financial intervention all the time.

The draft set of regulations below are considered as a possible legislative solution to the threat posed by unlimited state aid, to free and fair competition, the wider economy and the developmental goals of the government.

2 DRAFT ACT TO PROVIDE A FRAMEWORK FOR THE INPLEMENTATION OF A STATE AID CONTROL REGIME IN SOUTH AFRICA

ARRANGEMENT OF SECTIONS

PART 1: INTRODUCTION

1. Definitions

[30] A. Bartosch "Ten Years European State Aid Quarterly: A Little Jubilee and Ten Valid Reasons to Continue" (2012) 2 *European State Aid Quarterly* 307 307.

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PART 1: INTRODUCTION

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1. Definitions

In this Act-

"advisory opinion" means the non-binding recommendations issued by the Commission that *state aid* should not be given as it does not meet the requirements of section 6 and 9;

"beneficiary" means the enterprise which will or has received *state aid* and it may also refer to a private enterprise;

"*civil court*" has the meaning specified in section 1 of the *Competition Act*;

"constitutional institutions" means the public entities listed in Schedule 1 of the *PFMA*;

"*Commission*" means the Competition Commission of South Africa as described in the Competition Act 89 of 1998;

"*Competition Act*" means the Competition Act 89 of 1998;

"*de minimis state aid*" means *state aid* which is deemed to be of such a negligible value that it is not expected to have any impact on competition within a market;

"*emergency state aid*" means *state aid* which is granted in terms of section 16 of the *PFMA*;

"*fruitless and wasteful expenditure*" has the meaning specified in section 1 of the *PFMA*;

"government guarantee" is an assurance made by the national government, a provincial or local government to a lender that a financial obligation of an SOE will be honoured if and when the SOEs are unable to pay if there is compliance with section 218 of the Constitution of South Africa of 1996 and section 66 of the *PFMA*;[31]

[31] The first part of this definition has been taken from the definition by the National Treasury in the 2019 Budget Review 171 while the part mentioning section 218 of the Constitution has been added to the National Treasury's definition.

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"interested party" means any person, whose interests might be affected by the granting of *state aid* and may include beneficiaries of state aid and competitors of the beneficiaries of *state aid* or members of the public;

"*irregular expenditure*" has the meaning specified in section 1 of the *PFMA*;

''market inquiry'' has the meaning specified in section 43A of the Competition Act as amended by the Competition Amendment Bill of 2018, which is a formal inquiry in respect of the general state of competition, the levels of concentration in and structure of a market for particular goods or services, without necessarily referring to the conduct or activities of any particular named firm;

"*national department*" has the meaning specified in section 1 of the *PFMA*;

"National Revenue Fund" has the meaning specified by section 213 of the Constitution of the Republic of South Africa, 1996;

"National Treasury" means the National Treasury as described in section 5 of the PFMA;

"provincial department" has the meaning specified in section 1 of the *PFMA;*

"PFMA" means the Public Finance Management Act 1 of 1999;

"Provincial Revenue Fund" has the meaning specified by section 226 of the Constitution of the Republic of South Africa, 1996;

"recapitalisation" is the injection of funds into a company or entity to aid liquidity, either as a loan which is not made in the ordinary course of business or in return for equity;[32]

"state aid" means any aid granted to a state-owned enterprise by a *state aid grantor* that falls within section 3 and excludes any aid given in terms of section 6;

"state aid grantor" means the national, provincial or local government who plans to or grants aid or has granted aid;

[32] This definition is specified by the National Treasury in the 2019 Budget Review 175 and some addition was made to it.

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"*state-owned development financial institutions*" means a financial intermediary that aims to improve social welfare, by lending to priority sectors or target clientele while benefiting from some level of concessionary resources received from the state and/or donors;[33]

"*state-owned enterprise*" means any public entity listed as a national government business enterprise or a provincial government enterprise in Schedule 2 and 3 of the *PFMA* and those which provide goods and services in accordance with ordinary business principles with exclusion of the constitutional institutions listed in Schedule 1 of the *PFMA* and any board, commission, corporation, fund or other entities which are not a national or provincial government business enterprise or do not provide goods and services in accordance with ordinary business principles;

"transfers and subsidies" has the meaning specified in the annual *Appropriation Acts*.[34]

2. Purpose of this Act

The purpose of this Act is:

(a) to provide for a *state aid* regulatory regime to regulate the state funding of state-owned enterprises, as defined in section 1, which have the potential to prevent or lessen competition;

(b) to create a level playing field between state-owned enterprises and their competitors; and

(c) to promote the efficient operation of state-owned enterprises.

PART 2: STATE AID TO BE NOTIFIED AND EXEMPTIONS

3. Aid which shall be notified to the Commission

[33] For this definition, see J Yaron "State-Owned Development Finance Institutions (SDFI): The Political Economy and Performance Assessment" (2006) 30(1) *Savings and Development* 39 39.
[34] For instance, in the Appropriation Bill of 2019 "transfers and subsidies" are defined as "any payment made by a department classified as, or deemed to be, a transfer or subsidy payment in terms of the instructions issued in the *Guidelines for Implementing the Economic Reporting Format* (September 2009), in terms of section 76 of the Public Finance Management Act."

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(1) The following forms of aid will be covered by this Act as *state aid*-

(a) government guarantees which enables state-owned enterprises to access funding that would otherwise be unavailable or to borrow at a lower cost;

(b) *recapitalisation* of state-owned enterprises from the *National Revenue Fund* or a *Provincial Revenue Fund*;

(c) any form of tax advantage or exemption which is exclusively granted to state-owned enterprises and no other entities.

4. Aid which shall be exempted from notification

The following forms of aid will be exempted from the application of this Act and will not be regarded as state aid:

(a) transfers and subsidies, that are not *recapitalisation*, allocated from the annual budget of a *national* or *provincial department* to *state-owned enterprises* over which it has oversight and which:-

(i) enable those entities to execute their assigned mandates;

(ii) are granted for public interest reasons as provided in section 9(4); and

(iii) if not granted could obstruct the performance of the particular mandate assigned to a state-owned enterprise.[35]

(b) transfers and subsidies allocated from the annual budget of a *national* or *provincial department* to private enterprises which assist the government to achieve specified public interest objectives which are expressly mentioned in the annual budget of the *national* or *provincial department*;

(c) loans given to *state-owned enterprises* on normal business terms by *state-owned development financial institutions* that are in the business of providing credit or investment including the Land and Agricultural Bank of South Africa, the Industrial

[35] In this regard reference can be made to the annual appropriations made to an SOE such as PRASA for rail maintenance operations, signalling and refurbishment of coaches. If this aid is not granted, PRASA will be unable to perform its assigned mandate in an optimal way.

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Development Corporation of South Africa and the Development Bank of Southern Africa;

(d) aid in favour of research,[36] development and innovation[37] within individual sectors of the economy which is transferred from a *national* or *provincial department's* annual budget to *state-owned enterprises* over which they have oversight or to private enterprises;

(e) aid to remedy a serious disturbance or potential disturbance in the economy of South Africa, which will preserve financial stability; and

(f) de minimis *state aid*.

PART 3: PROCEDURE

5. Notification of *state aid* to the Commission

(1) Plans by a *state aid grantor* to grant *state aid* shall be notified to the Commission and the Commission shall confirm receipt of the notification, in formats prescribed by the Commission in regulation.

(2) Instead of the *state aid grantor*, the notification in subsection 1 may be given either by the *National* or *Provincial Treasury* or by the *national* or *provincial department* which has oversight of the *beneficiary* of the *state aid*.

(3) In the notification the *state aid grantor* shall provide all the required information regarding the *state aid* to enable the Commission to assess the impact of the *state aid* on competition in a relevant market.

(4) The *state aid grantor* shall not make a final decision to grant *state aid* until the Commission has delivered the reasons for its decision to the *state* aid *grantor* as provided for in section 9 or the time for evaluation of the *state aid* as provided in section 7 has elapsed, whichever is first.

[36] Examples include the state aid granted to private enterprises in terms of the government's "Recycling Enterprise Support Programme" for research and implementation of waste management projects.
[37] Examples include the state aid granted to private enterprises in terms of the government's "Support Programme for Industrial Innovation."

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(5) The *state aid grantor* must take an *advisory opinion* and recommendations into account in making a final decision to grant *state aid* as set out in subsection 4. Where the *state aid grantor* grants *state aid* despite an *advisory opinion* in terms of section 9 not to do so or without complying with recommendations made in terms of section 9 it shall provide the Commission with reasons for doing so.

(6) If the *state aid grantor* does not provide reasons as provided for in subsection 5 or if those reasons indicate that the *state aid grantor* has not given proper consideration to an *advisory opinion* or recommendations, the Commission will issue a declaration, which will be published on its website and sent to the *state aid grantor*, that despite an *advisory opinion* or recommendations proper procedures were not followed during the implementation of the *state aid*. The Commission's declaration can be used by any *interested party*:

(a) who can prove harm or damage as a result of the implementation of the *state aid* to challenge the *state aid* in a *civil court*;[38] or

(b) to apply for a review of the decision to give *state aid* without considering the recommendations of the Commission.

(7) The procedure in subsections 1 to 5 shall be followed even when the *state aid* is considered to be *emergency state aid* but the Commission should fast-track the evaluation and the issuing of its reasons as provided for in section 9(2) or the Commission should authorise implementation of the *emergency state aid* before completion of the evaluation and issuing of its recommendations.

6. Basic assessment of notified *state aid*

(1) The Commission must assess whether the *state aid* will substantially prevent or lessen competition in the relevant market or markets upon receipt of the notification in section 5 (1).

[38] The proposed position draws from the provisions of the Competition Act which allows any person who has suffered loss or damage from anti-competitive behaviour to commence action for damages in a civil court under section 65(6) if the Commission did not issue a consent order, confirmed by the Competition Tribunal, in terms of section 49D of the Act. The proposed position would be much like the position that transpired when SAA and the Minister of Public Enterprises were successfully sued for damages by Comair after it suffered harm as a result of SAA's anti-competitive behaviour.

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(2) The Commission shall, in determining whether competition is prevented or lessened, inter alia, take the following into account-

(a) the number of competitors operating in the relevant market;

(b) recent entrants into the relevant market;

(c) competitors that went out of business in the relevant market in the recent past;

(d) any past *advisory opinions* in terms of this Act or findings of contraventions of the Competition Act concerning the activities of the *beneficiary* of the *state aid*;

(e) the significance of the *state aid* to the *beneficiary* on the one hand and its potential impact on the business operations of well-functioning competitors in the relevant market on the other hand;

(f) previous *state aid* to the *beneficiary*;

(g) any operational losses suffered by the *beneficiary* during its previous financial year as shown by its financial statements;

(h) irregular, fruitless and wasteful expenditures identified by the Auditor-General of South Africa in the *beneficiary* that continue to affect the activities of the *beneficiary*; and

(i) governance and management concerns within the *beneficiary* of the *state aid* that continue to affect the activities of the *beneficiary*.

7. Time limit for the assessment of notified *state aid*

(1) The Commission shall have 40 business days[39] from the receipt of the notification in section 5 (1) to assess the *state aid* and issue its recommendations.

[39] In regard to the proposed time periods applicable to the assessment of *state aid* matters in South Africa, guidance was sought from the time periods applicable in EU state aid law, the time periods which will apply to the Competition and Market Authority (CMA) in Britain after its exit from the EU in terms of the *Brexit State Aid Regulations* and the time periods applicable to the Commission in South Africa, particularly in regard to mergers. The EU Commission has two months for a preliminary investigation after a notification of state aid, the CMA in Britain will have 40 working days to make a decision on the next step after receiving a notification of state aid and in South Africa the Competition Act allows the Commission 20 business days for a decision regarding intermediate mergers and 40 business days for a large merger.

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(2) The Commission may extend the period in subsection 1 by not more than 20 business days by informing the *state* aid *grantor* before the lapse of the time period provided in subsection 1 that it will extend the period within which it has to complete the assessment of the *state aid* and the issuing of its recommendations.

(3) Failure by the Commission to conclude its assessment of the *state aid* within the period in subsection 1 or extended period in subsection 2 shall allow the *state aid grantor* to implement the state aid.[40]

8. Submissions by interested parties and the *state aid grantor*

(1) During the period provided for in section 7 (1), interested parties shall be allowed to make representations on and objections to the *state aid*, to the Commission.

(2) The Commission must send to the *state aid grantor* any representations and objections it receives from interested parties, with the exception of confidential information and the identity of the *interested party* if so requested.

(3) The *state aid grantor* shall be given an opportunity to respond to any objections against the *state aid* by submitting reasons for the granting of the *state aid* within two weeks of receiving the representations from the Commission.

(4) When making the assessment provided for in section 6, the Commission shall take into account all representations and objections raised against the *state aid* by interested parties as well as the reasons for the granting of the *state aid* which were submitted by the *aid grantor*.

9. Decision and recommendations

(1) After completion of the assessment provided for in section 6, the Commission will make a decision that-

(a) the notified *state aid* will significantly prevent or lessen competition in the relevant market or markets as provided for in section 6 and the reasons for the *state aid* which were submitted by the *state aid grantor* or public interest as set out in section

[40] All proposed time periods for *state aid* matters are aligned with those in the Competition Act that have been tried and tested in regard to mergers since the inception of the Act in 1998.

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9(4) do not outweigh it or no reasons for the *state aid* were given by the *state aid grantor*;

(b) the notified *state aid* will significantly prevent or lessen competition in the relevant market as provided for in section 6 but the reasons for the *state aid* which were submitted by the *state aid grantor* under section 8(3) and/or public interest as set out in section 9(4) outweighs it; or

(c) the *state aid* will not significantly prevent or lessen competition in the relevant market as provided for in section 6.

(2) The Commission shall issue reasons for its decision:

(a) If the Commission makes a decision in accordance with subsection 1 (a), its reasons shall include an *advisory opinion* that the *state aid* should not be granted, and if relevant further show how the prevention or lessening of competition can be minimised.

(b) If the Commission makes a decision in accordance with subsection 1 (b) its reasons shall include its recommendation that the *state aid* may be granted and if relevant further shows how prevention or lessening of competition can be minimised without undermining the reasons for the *state aid* given by the *state aid grantor*.

(c) If the Commission makes a decision in accordance with subsection 1(c) its reasons shall include a recommendation that the *state aid* may proceed.

(3) The reasons as required by subsection 2 shall be delivered to the *state aid grantor*, each *interested party* who made submissions on the *state aid* as provided in section 8, the beneficiary of the *state aid* and shall also be published on the website of the Commission.

(4) If the Commission makes a decision in accordance with subsection 1 (b), in addition to taking into account the reasons submitted by the *state aid grantor*, the Commission must also take into account the effect of the state aid on[41]-

[41] The listed public interest grounds draw from the purpose clause of the Competition Act and the public interest grounds in section 12A(3) of the Act which needs to be considered by the competition authorities when determining whether a merger can or cannot be justified.

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(a) the social and economic welfare of South Africans including employment;

(b) the ability of the beneficiaries to deliver their mandates effectively, which *inter alia* include the provision of water, sanitation, communications, energy and transportation infrastructure and services;

(c) the government's long term endeavour to spread ownership in the South African economy, in particular ownership of historically disadvantaged persons;

(d) a particular industrial sector or region; and

(e) the ability of the beneficiaries to compete in international markets.

10. Failure to notify state aid before a final decision to grant it

(1) When a *state aid grantor* or others who may notify on its behalf as provided in section 5(2) has failed to comply with the notification obligation provided for in section 5:

(a) the Commission may on its own initiative start an investigation into *state aid* which was not notified, similarly to a *market inquiry*; or

(b) *interested parties* when becoming aware of the *state aid* may request that the Commission do an investigation into the *state aid* and simultaneously make representations and provide information from any source to the Commission on the *state aid*;

(c) the *state aid grantor* or others who may notify on its behalf as provided for in section 5(2) may give a late notification which will have to comply with the procedural requirements set out in section 5(1)-5(3).

(2) Should the Commission decide to starts an investigation of its own accord or after having received a request from an *interested party* as provided in subsection 1, the Commission shall notify the *state aid grantor* of its intention to investigate the *state aid* and it should give the *state aid grantor* a reasonable opportunity to give a late notification of the *state aid.*

(3) If the *state aid grantor*, after having been informed by the Commission of its intention to investigate *state aid* which was not notified, still fails to give late

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notification within two weeks of notification, the Commission may proceed with an investigation into the *state aid*.

(4) If the Commission starts an investigation in terms of section 10(3) or a *state aid grantor* gives late notification, and any part of the *state aid* has not yet been implemented, the *state aid grantor* is not allowed to further implement the *state aid* until the Commission completes the investigation and issues an *advisory opinion* and/or makes recommendations as set out in section 9.

(5) Even where the Commission has proceeded with an investigation in terms of section 10(3), the *state aid grantor* must be given an opportunity to provide the Commission with information during the period of the investigation on the *state aid* and the notice provided for in section 10(2) must clearly state this.

(6) To assist the Commission with an investigation into *state aid* that was not notified in terms of section 5 or where no late notification was made in terms of section 10(2), the Commission may require disclosure of information from the *state aid grantor* to enable it to assess the impact of the *state aid* on competition in the relevant market or markets.

(7) If the *state aid grantor* refuses to provide the information which was required under subsection 6, the Commission may lodge a request with the *National* or *Provincial Treasury* for the required information, inform the *state aid grantor* that such a request was made and upon receipt of the information from the relevant treasury make an assessment of the *state aid* as provided in section 6.

(8) Section 6, 7, 8 and 9 will apply with the necessary changes to investigations and late notifications in terms of this provision. In particular:

(a) a reference to “the notification” in these proceedings will be read to refer to a late notification or the commencement of an investigation in terms of section 10(3) as the case may be.

(b) interested parties will include a complainant as provided for in section 10(1).

(c) any reference to granting of *state aid* will be read to refer to further implementing unimplemented *state aid* or recovering implemented *state aid*.

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(9) Where an investigation is done in terms of section 10(2) or a late notification is made, the *state aid grantor* must make a final decision whether unimplemented *state aid* should be implemented and whether *state aid* that has been implemented must be recovered.

(10) *State aid* already implemented before this decision will not be illegal but it may be recovered if the Commission has given an *advisory opinion* or recommendation that this should be done.

(11) In making the decision set out in section 10(9), the *state aid grantor* must take an *advisory opinion* and recommendations into account in making a final decision whether to proceed with the implementation of *state aid* that has not yet been implemented or to recover *state aid* that has already been implemented. Where the *state aid grantor* implements *state aid* or refrains from recovering *state aid* despite an *advisory opinion* to the contrary, it shall provide the Commission with reasons for doing so.

(12) If the *state aid grantor* does not provide reasons as provided for in section 10(11) or if those reasons indicate that the *state aid grantor* has not given proper consideration to an *advisory opinion* or recommendations, the Commission will issue a declaration, which will be published on its website and sent to the *state aid grantor*, that despite an *advisory opinion* or recommendations proper procedures were not followed during the implementation of the *state aid*. The Commission's declaration can be used by any *interested party*:

(a) who can prove harm or damage as a result of the implementation of the *state aid* or the failure to recover the *state aid*, to challenge the *state aid* in a civil court; or

(b) to apply for a review of the decision to further implement or failure to recover *state aid* without considering the recommendations of the Commission.[42]

PART: GENERAL PROVISIONS

[42] The proposed relief provided in this provision draws from the provisions of the Competition Act which allows any person who has suffered loss or damage from anti-competitive behaviour to commence action for damages in a civil court under section 65(6) if the Commission did not issue a consent order, confirmed by the Competition Tribunal, in terms of section 49D of the Act.

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11. Conflict with other parliamentary acts[43]

(1) In the event of conflict between this Act and an Act of Parliament which makes provision for *state aid* to SOEs, an attempt should be made to interpret this Act and the Act of Parliament in a manner that allows for them to be applied concurrently.

(2) If and to the extent that a concurrent application as provided for in subsection 1 is not possible with regard to an Act that precedes this Act, the provisions of this Act will prevail in terms of the normal rules of interpretation as it is a subsequent enactment unless it is clearly evident from an interpretation of this Act read with the conflicting Act that the conflicting Act should prevail over this Act.

(3) If and to the extent that a concurrent application as provided for in subsection 1 is not possible with regard to an Act that is enacted after this Act, the provisions of this Act will prevail unless the latter Act clearly states that it is to prevail over this Act or a category of Acts that includes this Act.

(4) When the provisions of the conflicting Act must prevail in terms of subsection 2 or 3, the supremacy of that Act does not prevent the Commission from doing on its own initiative an assessment of the impact of the *state aid* on relevant markets, similar to a *market inquiry*.

(5) When making the assessment in subsection 4, the Commission may make any of the decisions set out in section 9(1) and the Commission must give reasons and may issue recommendations which will enable the *state aid grantor* to safeguard the relevant market against any potential negative impact of the *state aid*. The reasons and recommendations must be delivered to the *state aid grantor* and published in the manner set out in section 9(3). However, the legal consequences for

[43] Guidance for this provision was sought from the state aid rules which will apply in Great Britain after its exit from the EU as any position on conflict is non-existing in EU state aid law due to the nature of EU state aid rules. The *Brexit State Aid Regulations* do deal with state aid granted or to be granted in an Act of Parliament in Schedule 3 of that legislation. One aspect of the *Brexit State Aid Regulations* that stand out is that the Competition and Market Authority will still be allowed to issue advice on state aid, either on its own initiative or on request of a Minister of the Crown, regardless of the fact that the state aid is granted or to be granted in an Act of Parliament. The *Brexit State Aid Regulations* were kept simple by just stating whether a proposal qualifies indeed as one to grant state aid in an Act of Parliament or whether state aid has been granted by an Act of Parliament. The *Brexit State Aid Regulations* therefore do not cover conflict with other parliamentary legislation. Hence, it is not of particular assistance when it comes to the matter of conflicting legislation. In this regard an own position for South Africa will have to be proposed by this study.

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recommendations and *advisory opinions* as set out in section 5(4)-5(6) or 10(9)-10(12) will not apply to these recommendations.

(6) A *state aid grantor* must provide the Commission with information which the Commission may need for its own initiated assessment as provided in subsection 5. Should the *state aid grantor* also provide access to confidential information, the Commission is required to treat such information with confidentiality.

(7) To avoid potential conflict between this Act and a future Act of Parliament, a *state aid grantor* who considers or proposes the granting of *state aid* in an Act of Parliament, should notify the proposed state aid to the Commission in accordance with section 5, where after the Commission will assessed the *state aid* in accordance with section 6 and within the time limits provided in section 7 and issue a decision and recommendations in terms of section 9.[44]

12. Act applies only to *state aid* granted after the date on which this Act comes into effect

(1) This Act only applies to grants of *state aid* that take place after its commencement.

(2) Where a decision to grant *state aid* is made in terms of a power established by an Act that precedes this Act, after the commencement of this Act, it will constitute *state aid* in terms of this Act unless it is excluded in terms of section 11. If it is excluded the Commission is not prevented from assessing the *state aid* as provided in section 11(4).

(3) Subject to subsection 4, if *state aid* is granted directly in terms of legislation this Act will only apply to *state aid* granted in terms of legislation enacted after commencement of this Act.

(4) Where *state aid* granted directly in terms of legislation enacted before this Act continues after the commencement of this Act, the Commission may make any of the decisions set out in section 9(1) and the Commission must give reasons and may

[44] This provision is to a great degree based on the provisions in the *Brexit State Aid Regulations* which state what would happen when there is a proposal to grant state aid in an Act of Parliament or when state aid was already granted in an Act of Parliament.

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issue recommendations which will enable the *state aid grantor* to safeguard the relevant market against any potential negative impact of the *state aid*. The reasons and recommendations must be delivered to the *state aid grantor* and published in the manner set out in section 9(3). However, the legal consequences for recommendations and *advisory opinions* as set out in section 5(4)-5(6) or 10(9)-10(12) will not apply to these recommendations.[45]

13. Market inquiries on the effect of *state aid* in markets

(1) In addition to its powers to assess *state aid* listed in section 4, the Commission shall have the power to do *market inquiries* into the potential effects of *state aid* on competition and economic transformation.

(2) The Commission shall conduct *market inquiries* in accordance with the procedure provided in Chapter 4A of the Competition Act, as amended by the Competition Amendment Bill of 2018.

(3) If the Commission concludes during a *market inquiry* on the effect of *state aid* in a relevant market that it has an adverse effect on competition, the Commission shall make recommendations to the *state aid grantor* to take action to remedy, mitigate or prevent the adverse effect on competition.

14. Short title

This Act is called the State Aid Regulation Act of 2020.

END OF CHAPTER

[45] In regard to this provision, guidance was sought from the provisions in the *Brexit State Aid Regulation* which deals with "Existing Aid Schemes". The public interest focus of the provision brings it more in line with the domestic position in South Africa.

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